



Legislative Audit Division

State of Montana

Report to the Legislature

December 2006

Financial Audit

For the Fiscal Year Ended June 30, 2006

The University of Montana

A component unit of the state of Montana

We performed a financial audit of The University of Montana's consolidated financial statements for the fiscal year ended June 30, 2006. These financial statements present the financial position, the results of operations, and cash flows, on a consolidated basis, of all four campuses affiliated with The University of Montana: The University of Montana-Missoula; Montana Tech of The University of Montana (located in Butte); The University of Montana-Western (located in Dillon); and The University of Montana-Helena College of Technology.

The statements include component unit financial information as required under GASB 39. This report contains an unqualified opinion on The University's financial statements and accompanying notes for the fiscal year ended June 30, 2006, and the comparative information for the fiscal year ended June 30, 2005. This opinion means the reader may rely on the financial statement information presented. The supplemental information on page A-42 is presented for additional analysis.

This audit is performed to attest to the fairness of the consolidated financial statements of The University of Montana. Audit issues, if any, identified during this audit have been discussed with university management and, if appropriate, will be reported in our financial-related audit of The University for the two fiscal years ended June 30, 2007.

Direct comments/inquiries to:
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Room 160, State Capitol
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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, will be issued by March 31, 2008. The Single Audit Report for the two fiscal years ended June 30, 2005, was issued on March 6, 2006. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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James Gillett
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December 2006

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report on The University of Montana's consolidated financial statements for the fiscal year ended June 30, 2006. The statements include comparative information for the fiscal year ended June 30, 2005. The University requests annual financial audits to provide timely audited financial statements to interested parties. The objective of our audit was to determine if The University's financial statements present fairly its financial position, changes in financial position, and cash flows as of June 30, 2006, and for the fiscal year then ended. This objective included determining The University's compliance with laws and regulations having a direct and material impact on the financial statements. Our opinion for fiscal year 2004-05 is based on the audit we performed in the fall of 2005.

The University of Montana consists of campuses located in Missoula, Butte, Dillon, and Helena. The campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges and provide a diversity of programs to students.

The University of Montana-Missoula is a comprehensive university offering four-year undergraduate programs along with master and doctoral graduate programs. It includes professional schools and significant research activities. The campus is the center of liberal arts education in the Montana University System and operates the only law school in the system. Other schools include business administration, education, fine arts, forestry, pharmacy and allied health services, and journalism. In addition, the campus includes a two-year college of technology that provides a broad range of technical and occupational education and training courses.

Montana Tech of The University of Montana provides a variety of four-year and graduate programs with a focus on mineral, geological, environmental, petroleum, mining, and other engineering and science programs and majors. It also includes a college of technology that provides two-year degrees in various occupational and technical programs and core education courses.

The University of Montana-Western provides both two-year and four-year undergraduate degree programs with a focus on elementary and secondary education. It also provides a four-year liberal arts degree with several emphases that complement the education programs.

The University of Montana-Helena College of Technology provides two-year Associate of Science degree programs and a variety of other occupational, technical, and training specialties. These areas include accounting technology, carpentry, computer technology, practical nursing, electronics technology, and welding technology. The college serves as a higher education center by offering

certain courses transferable to degree programs offered at other campuses of the Montana University System.

A list of Appointed and Administrative Officials having oversight responsibilities with respect to The University of Montana can be found on page i.

Beginning on page A-1, you will find the Independent Auditor's Report followed by The University's financial statements and accompanying notes. We issued an unqualified opinion on The University's consolidated financial statements, which means the reader can rely on the presented information.

This report does not contain any recommendations to The University. Any audit issues identified during this audit have been discussed with university management. The University's response to this report is on page B-1.

We thank President Dennison and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Board of Regents of Higher Education

Brian Schweitzer, Governor*
Linda McCullough, Superintendent of Public Instruction*
Sheila M. Stearns, Commissioner of Higher Education*

Lynn Morrison-Hamilton, Chair
Stephen M. Barrett, Vice Chair
Clayton Christian, Regent
Heather O'Loughlin, Student Regent
Dr. Janine Pease, Regent
Mark Semmens, Regent
Lila Taylor, Regent

*Ex officio members of the Board of Regents

Commissioner of Higher Education

Sheila M. Stearns	Commissioner of Higher Education
Roger Barber	Deputy Commissioner for Academic and Student Affairs
Mick Robinson	Associate Commissioner for Fiscal Affairs
Cathy Conover	Interim Associate Commissioner for Research, Technology and Communications
Frieda Houser	Director, Accounting and Budgeting
Cathy Swift	Chief Legal Counsel

The University of Montana, All Campuses

George M. Dennison	President
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The University of Montana-Missoula

George M. Dennison	Interim Provost and Vice President, Academic Affairs
Robert Duringer	Vice President for Administration and Finance, University Vice President
Daniel J. Dwyer	Vice President for Research and Development, University Vice President
Teresa S. Branch	Vice President for Student Affairs, University Vice President
David Aronofsky	Legal Counsel
Mark Pullium	Director of Business Services

Appointed and Administrative Officials

Montana Tech of The University of Montana

W. Franklin Gilmore	Chancellor and University Executive Vice President
Susan B. Patton	Vice Chancellor for Academic Affairs and Research, University Associate Provost
Joseph F. Figueira	Vice Chancellor for Research, Graduate Studies, and International Programs, University Associate Vice President
John C. Badovinac	Controller/Business Manager
Lynn Job	Director of Contracts and Grants

The University of Montana- Western

Richard Storey	Chancellor, University Executive Vice President
Karl E. Ulrich	Vice Chancellor for Academic Affairs
Susan D. Briggs	Vice Chancellor for Administration and Finance, University Associate Vice President
Virginia Dale	Director of Business Services

The University of Montana- Helena College of Technology

Daniel Bingham	Dean/CEO
Brandi Foster	Associate Dean for Academic Affairs
Christobal Valdez	Assistant Dean for Student Services
Russ Fillner	Assistant Dean for Fiscal and Plant Operations

For further information on The University of Montana contact:

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Members of the audit staff involved in this audit were Pearl M. Allen, Rick Eneas, Cindy S. Jorgenson, and Laura L. Norris.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Jim Pellegrini

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Consolidated Statements of Net Assets of The University of Montana, a component unit of the state of Montana, as of June 30, 2006, and 2005, and the related Consolidated Statements of Revenues, Expenses and Changes in Net Assets and Consolidated Statements of Cash Flows for the fiscal years then ended and the University Component Units - Combined Statements of Financial Position as of June 30, 2006, and 2005, and the related University Component Units - Combined Statement of Activities for the fiscal years then ended. The information contained in these financial statements is the responsibility of the university's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the university's aggregate discretely presented component units. Those statements, which include The University of Montana Foundation, the Montana Tech Foundation, The University of Montana-Western Foundation, and the Montana Grizzly Scholarship Association, were audited by other auditors whose reports thereon have been furnished to us, and our opinion insofar as it relates to the amounts included for the component units of the university, as noted above, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of Montana and the aggregate discretely presented component units as of June 30, 2006, and 2005, and the respective changes in financial position and cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages A-3 through A-11 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation

of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements of The University of Montana. The Supplemental Information on page A-42 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 9, 2006

**The University of Montana's
Management's Discussion and Analysis,
Financial Statements, Notes, and Supplemental Information**

THE UNIVERSITY OF MONTANA

THE UNIVERSITY OF MONTANA - MISSOULA

THE UNIVERSITY OF MONTANA - WESTERN

THE UNIVERSITY OF MONTANA - HELENA COLLEGE OF TECHNOLOGY

MONTANA TECH OF THE UNIVERSITY OF MONTANA

MANAGEMENT'S DISCUSSION AND ANALYSIS

FISCAL YEAR ENDED JUNE 30, 2006

OVERVIEW

The University of Montana (University) is comprised of four campuses: The University of Montana - Missoula; The University of Montana - Western; The University of Montana - Helena College of Technology; and Montana Tech of The University of Montana. This discussion addresses the consolidated financial statements for the four campuses, and included are three basic statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

The discussion and analysis which follows provides a comparative overview of the University's financial position and operating results for the fiscal years ended June 30, 2006, 2005, and 2004 and should be read in conjunction with the fiscal year 2006 financial statements.

INCLUSION OF COMPONENT UNITS

In May of 2002, the Governmental Accounting Standards Board (GASB) issued Statement No. 39, "Determining Whether Certain Organizations are Component Units". This guidance was applied to financial statements for accounting periods which began after June 15, 2003, or in our case for the financial statements for the fiscal year ended June 30, 2004. Accordingly, we include in our financial statements information on four entities which qualify as component units. Those are The University of Montana Foundation, the Montana Tech Foundation, The University of Montana - Western Foundation, and the Montana Grizzly Scholarship Association.

These four component units are legally separate, tax-exempt entities that issue their own financial statements in a format promulgated by the Financial Accounting Standards Board (FASB), and not by GASB. As a result, their financial information is issued on separate pages from the consolidated financial information of the four campuses. We have provided a Statement of Financial Position and a Statement of Activities for the component units, presented in a "consolidated" format. More detailed information about the individual component units is provided in the notes to the financial statements.

FINANCIAL HIGHLIGHTS

The financial highlights for fiscal year 2006 were:

- On September 15, 2005, the Board of Regents (Board) and the University issued \$31,095,000 of Facilities Improvement Bonds, Series J 2005. Over \$21 million of the proceeds from the issuance, combined with certain other funds and monies of the Board and the University, are being used primarily to finance or refinance the costs of acquiring, constructing, furnishing, equipping, renovating, improving or repairing certain University facilities. The remaining \$10 million of bond proceeds were used to advance refund a portion of Facilities Improvement Bonds, Series F 1999.

- In addition, the University intends to refund the remaining unrefunded portion of the Series F 1999 bonds by issuing variable rate Series K 2010 bonds for a maximum principal amount of \$47 million. The University entered into a forward swap agreement in August, 2005 with Wachovia Bank to hedge the interest rate risk associated with the potential future issuance of the variable-rate revenue bonds. In exchange, the University received \$2,094,500 from Wachovia. Under the terms of the swap, the University will pay Wachovia a fixed rate substantially equal to the unrefunded Series F 1999 bonds, and Wachovia Bank will pay the University a floating rate based on the LIBOR rate. The intention of the University in entering into these transactions is to reduce the cost of its borrowings.
- Net assets of the University increased by \$16.4 million due primarily to an increase in private gifts income of \$5.8 million associated with several capital projects on the Missoula campus, and an increase in investment earnings.
- Tuition rate increases for the year ended June 30, 2006 were 7% for the Western campus, 8% for the Missoula campus, 12% for the Montana Tech campus, and 4% for all of our Colleges of Technology. The total tuition revenue increase for all four campuses, net of scholarship allowances, for the 2006 fiscal year was nearly \$4.2 million.
- Investment earnings increased by \$2.6 million over the prior year. The significant increase can in part be attributed to continued higher yields on interest bearing investments and the increase in fair value of pooled equity investments. The progressively higher federal funds rates achieved in the prior year were sustained through FY06. An additional factor contributing to the increase in investment earnings was the investment of approximately \$21 million of Series J bond proceeds, which were held in various interest bearing investments during the year.
- Considerable attention was given during FY 04 to a deficit experienced by the UM Athletics Department at the Missoula campus. A plan was put in place to eliminate the accumulated deficit in the Athletics Department within five years. During FY 06, Athletics continued to exceed the targets of the deficit elimination plan, and the deficit was reduced by \$370,000 from \$562,626 at June 30, 2005 to \$192,626 at June 30, 2006.

The financial highlights for fiscal year 2005 were:

- Tuition rate increases for the year ended June 30, 2005 were 8.5% for the Missoula and Western campuses, 12% for the Montana Tech campus, and 6% for all of our Colleges of Technology. The resulting tuition revenue increase, net of scholarship allowances, for the 2005 fiscal year was nearly \$4.4 million.
- Net assets of the University increased by more than \$7.8 million. The largest single source of that increase was a \$3.4 million endowment from the National Institute of Health to the School of Pharmacy and Allied Health Sciences for training, educating, and supporting research by minority faculty and students. The other major source was \$2.8 million which is associated with a number of capital projects.

- Investment earnings increased significantly by about \$1.25 million in FY 05. This is primarily attributable to higher yields on interest bearing investments. The Federal Open Market Committee raised the benchmark short term interest rate- the federal funds rate- several times during the year, resulting in progressively higher yields over the course of the year.
- During FY 05, Athletics significantly exceeded the targets of the deficit elimination plan discussed above, and the deficit was reduced by \$400,000 from \$962,626 at June 30, 2004 to \$562,626 at June 30, 2005.

USING THE FINANCIAL STATEMENTS

The University's financial statements consist of the following three statements: Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows.

In addition, we prepare and present a Statement of Activities and a Statement of Financial Position for the four component units mentioned previously. A discussion of each of the individual statements follows. Some key points to be aware of regarding the statements are:

- These are consolidated financial statements representing the University's four campuses.
- The financial statements are prepared using the accrual basis of accounting, which means revenues are reported when earned, and expenses are reported when incurred.
- Assets and liabilities presented in the financial statements are generally measured at current value, although capital assets are stated at historical cost less accumulated depreciation.
- Capital assets are classified as depreciable and non-depreciable. Depreciation is treated as an operating expense.
- Assets and liabilities are treated as current (Due within one year) or as non-current (Due in more than one year), and are presented in the Statement of Net Assets in order of liquidity.
- Revenues and expenses are classified as operating or non-operating. "Operating" is defined as resulting from transactions involving exchanges of goods or services for payment, while "non-operating" is defined as resulting from transactions not involving the exchange of goods or services for payment. We show a substantial operating loss on the Statement of Revenues, Expenses, and Changes in Net Assets primarily because GASB requires that General Operating Fund expenses be reported as operating, while the State Appropriation - which is General Operating Fund revenue - must be reported as non-operating.
- Tuition and fees are reported net of any scholarships or fellowships that were applied directly to a student's account. The reason for "netting" these is to keep the University financial statements from "double counting" this revenue and expense.

STATEMENT OF NET ASSETS

The Statement of Net Assets reflects the financial position of the University at the end of the fiscal year. The changes in net assets that occur over time indicate improvements or deterioration in the University's financial position. A summary of the Statement of Net Assets follows:

For the years ended June 30, (stated in millions) (Restated)			
Description	2006	2005	2004
Total current assets	\$ 106.40	\$ 85.03	\$ 76.41
Total non-current assets	283.88	272.97	275.07
Total assets	390.28	\$ 358.00	\$ 351.48
Total current liabilities	\$ 44.49	\$ 45.46	\$ 42.66
Total non-current liabilities	175.54	158.64	162.70
Total liabilities	220.03	204.10	205.36
Invested in Capital Assets, Net of Related Debt	119.58	105.95	108.32
Restricted:			
Nonexpendable	17.83	15.68	12.16
Expendable	5.54	5.31	5.36
Unrestricted	27.30	26.96	20.28
Total net assets	170.25	153.90	146.12
Total liabilities and net assets	\$ 390.28	\$ 358.00	\$ 351.48

Events or developments that occurred which had a significant impact on the Statement of Net Assets include:

Events or developments which occurred during 2006:

- Current assets increased by \$21.4 million, with most of that change resulting from an increase in cash and cash equivalents of \$27.3 million. Most of the increase was from Series J 2005, bond proceeds invested in highly liquid guaranteed investment contracts and will be used to pay for several major capital projects.
- Non current assets increased by \$10.9 million primarily from additions to capital assets of \$25.9 million net of an increase to accumulated depreciation of \$16.4 million.
- Non current liabilities increased by \$16.9 million due primarily to the issuance of Series J 2005 revenue bonds, which was offset by principal payments of \$5.0 million related to revenue bonds outstanding in FY06.
- Net assets of the University increased by \$16.4 million due primarily to an increase in private gifts income of \$5.8 million associated with the construction of the Skaggs and Journalism buildings on the Missoula campus and also, from an increase in investments earnings.

Events or developments which occurred during 2005:

- Current assets increased by more than \$8.6 million, with most of that change resulting from an increase in cash and cash equivalents of \$4.3 million. That increase was comprised

primarily of \$1.3 million from grant and contract activity and \$2.1 million from plant fund investments which matured in FY 05 and will be used to pay for a major capital project. Also, investments increased by more than \$4.5 million. Most of that increase is attributable to U.S. Treasury Securities which were reclassified in FY 05 to current assets because they will mature during FY 06. These investments were from bond proceeds which were received at the end of FY 04, and are to be used for funding the capital project referred to above.

- Total Liabilities decreased by about \$1.3 million. The major type of liability that decreased (by \$4.4 million) was long term obligations. Conversely, a number of types of liabilities showed increases, with the largest being about \$ 900,000 in the current portion of long term debt. Smaller increases of \$400,000 to \$500,000 each were recognized in accounts payable and accrued liabilities; due to primary government; deferred revenue; accrued compensable absences; and advances from primary government.
- Net Assets increased significantly by \$7.8 million. The largest single contributor to this was the \$3.4 million NIH endowment made to the School of Pharmacy and Allied Health Sciences.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Net Assets present the results of the University's operational activities for the fiscal year, categorizing them as either operating or non-operating items. See Consolidated Statements Financial Statement Note 2, "Summary of Significant Accounting Policies" for further explanation. Consistent with the accrual method of accounting, the current year's revenues and expenses are recognized when they were earned or incurred, regardless of when cash was received or paid.

A summary of the Statement of Revenues, Expenses and Changes in Net Assets follows:

	For the years ended June 30, (stated in millions)		
	2006	2005	2004
Description			
Operating revenue	227.02	\$ 218.18	\$ 206.14
Operating expenses	291.66	280.35	266.27
Operating loss	(64.64)	(62.17)	(60.13)
Non-operating revenues (expenses)	76.91	64.14	61.94
Income (loss) before other revenues	12.27	1.97	1.81
Other revenues	4.09	5.81	5.35
Net increase in net assets	16.36	7.78	7.16
Net assets, beginning of year, as adjusted	153.89	146.11	138.33
Prior Period Adjustments (Net)	-	-	0.62
Net assets, end of year	\$ 170.25	\$ 153.89	\$ 146.11

The following provides a comparative analysis of revenues and expenses for the years ended June 30, 2006, 2005, and 2004:

For the years ended June 30, (stated in millions)						
REVENUES	2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent
Tuition and fees, net	\$ 87.93	27.9%	\$ 83.08	28.2%	\$ 76.60	27.4%
Federal grants and contracts	64.65	20.5%	65.67	22.3%	64.72	23.2%
State & local grants/contracts	8.91	2.8%	7.42	2.5%	5.64	2.0%
Nongovernmental grants/contracts	4.99	1.6%	3.99	1.3%	4.80	1.7%
Facilities and administrative cost allowances	9.79	3.1%	10.42	3.5%	9.70	3.5%
Sales/services of educational departments	12.35	3.9%	12.28	4.2%	10.51	3.8%
Auxiliary enterprise charges	32.87	10.4%	30.08	10.2%	29.56	10.6%
State appropriations	62.07	19.7%	56.70	19.2%	58.05	20.8%
Investment income	5.18	1.6%	2.57	0.9%	1.31	0.4%
Private gifts	15.58	4.9%	9.73	3.3%	8.45	3.0%
Capital grants and gifts	3.06	1.0%	5.81	2.0%	5.35	1.6%
All other sources combined	8.01	2.6%	6.98	2.4%	5.80	2.0%
	\$ 315.39	100.0%	\$ 294.73	100.0%	\$ 280.49	100.0%
EXPENSES	Amount		Amount		Amount	
	Amount	Percent	Amount	Percent	Amount	Percent
Compensation and benefits	\$ 185.88	62.2%	\$ 175.85	61.2%	\$ 168.37	61.6%
Other operating expenses	73.79	24.7%	72.73	25.4%	66.90	24.5%
Scholarships and fellowships	15.28	5.1%	15.70	5.3%	15.17	5.5%
Depreciation and amortization	16.71	5.6%	16.07	5.6%	15.84	5.8%
Interest expense	7.37	2.4%	6.60	2.5%	7.05	2.6%
	\$ 299.03	100.0%	\$ 286.95	100.0%	\$ 273.33	100.0%

Comments about specific revenue and expense items are:

Events or developments which occurred during 2006 include:

- Tuition and fees (net) increased by nearly \$4.9 million, with approximately \$4.2 million of the increase attributable to higher tuition rates, and the remainder to higher enrollments in FY06.
- Federal contracts and grants revenue and facilities and administrative cost allowances declined in total by over \$1.6 million in FY06, reflecting the difficulty in obtaining federal funding. The University has put more effort in obtaining state and local contracts as a result, and revenue from these sources increased by \$2.5 million.
- State appropriation increased by \$5.4 million, with about \$4.5 million attributable to an increase in funding to the Montana University System for the 2006-2007 Biennium, approved by the 2005 state legislature. The remainder of the increase is from a special appropriation for program development at our colleges of technology.

- Private gifts increased by \$5.8 million, with most of the increase from foundation donations for several capital projects on the Missoula campus.
- Investment earnings increased by \$2.6 million due to higher yields on interest bearing investments, a fairly significant increase in fair value of pooled equity investments and the investment of approximately \$21 million of Series J bond proceeds, which were held in various interest bearing investments during the year.
- The relative percentages in the broad categories for other revenues and expenses were consistent with the relative percentages between the two years.

Events or Developments which occurred during 2005 include:

- Tuition and Fees (net) increased by about \$6.5 million, with about \$4.4 million being attributable to higher tuition rates, and the remainder to higher enrollments in FY 05.
- Our state and local contracts and grants grew fairly substantially (by about \$1.8 million, or more than 30%). Some efforts to secure contract and grant funding were refocused from federal to state sources, as federal awards became more difficult to obtain.
- State Appropriations decreased by about \$1.3 million. This is primarily attributable to the fact that the University of Montana asked for and was granted permission to “carry back” approximately \$732,000 of State Appropriation from FY 05 to FY 04. The purpose of this was to smooth out revenues in the general fund over the two years of the biennium which ended on June 30, 2005.
- Both revenues and expenses increased by about \$14.2 million and \$13.6 million, respectively. The relative percentages in the broad categories of expense were very consistent between the two years.
- Prior Period Adjustment. In 2005, it was determined that certain transactions that occurred during previous fiscal years were incorrectly reported. The correction of these transactions has resulted in a restatement of the consolidated financial statements for the year ending June 30, 2004. In the year ended June 30, 2003, the University was awarded an endowment through a federally sponsored endowment award program. The amounts received in the years ending June 30, 2003 and 2004 under the program were not properly reflected as an endowment investment on the University’s consolidated financial statements. This has resulted in a \$2,097,204 restatement of endowment investments on the consolidated Statement of Net Assets at June 30, 2004, and a restatement of \$993,051 to net assets – beginning of year, and other related activity on the consolidated Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows for that fiscal year.

STATEMENT OF CASH FLOWS

The Statement of Cash Flows provides information about the University’s sources and uses of cash during the fiscal year. This statement aids in assessing the University’s ability to meet obligations and commitments as they become due, their ability to generate future cash flows, and their needs for external financing. As required by GASB, the statement is presented using the “Direct Method”, which focuses on those transactions that either provided or used cash during the fiscal year.

CASH FLOW CATEGORY	For years ended June 30,		
	(stated in millions)		
	2006	2005	2004
Cash Provided by(Used for):			
Operating Activities	\$ (49.19)	\$ (43.95)	\$ (42.14)
Non-capital Financial Activities	80.66	71.61	68.62
Capital and Related Financial Activities	(13.85)	(24.17)	(24.47)
Investing Activities	8.98	(3.06)	0.19
Net Increase in Cash	26.60	0.43	2.20
Cash and Cash Equivalents, beginning of year	58.03	57.60	55.40
Cash and Cash Equivalents, end of year	\$ 84.63	\$ 58.03	\$ 57.60

Specific events or cash transactions which occurred during FY 06 which were notable included:

- Cash flows from operating revenues increased by approximately \$11.0 million, due primarily to an increase in cash flows from tuition and fees and auxiliary enterprise charges totaling \$7.9 million. This increase in cash flows was offset by an increase in operating expenses of \$16.3 million due largely to an increase in payments for salaries and benefits of \$13.7 million.
- Noncapital financing activities provided additional cash flows over the prior year due to an increase in state appropriations of \$5.4 million and a significant increase in private gifts of \$5.8 million, designated primarily for use by several capital building projects.
- Cash flows provided by investing activities increased in excess of \$12.0 million over FY 05. A major reason for the increase was due to the increase in maturities of close to \$6.0 million of debt securities during the year, and a corresponding decrease in investments of \$3.3 million compared to FY 05. The proceeds from the maturity of debt securities were used to fund capital construction activities. Another factor contributing to the increase in cash flows from these activities was an increase in investment earnings of \$2.4 million, resulting from higher yields on interest bearing investments.
- Overall, cash flows from capital and related financing activities increased by \$12 million in FY06. Proceeds from the issuance of Series J 2005 bonds net of payments to defease a portion of Series F 1999 bonds, increased cash flows by \$21 million. This increase was offset by cash used for acquiring capital assets, which increased by \$8.5 million over FY 05.

Specific events or cash transactions which occurred during FY 05 which were notable included:

- Regarding Cash flows from operating activities: The University generated about \$5.7 million more in cash inflow from Tuition and Fees in FY 05. Categories of cash outflows which increased most in FY 05 were about \$6 million for salaries and benefits, and \$5.5 million for operating expenses, which includes a \$1.5 million utility increase.
- Cash flowing in from noncapital financing activities increased approximately \$3 million from FY 04 to FY 05. The \$3.4 million NIH endowment award accounted for most of this.
- Investing activities were attributed with using about \$3.2 million more of cash in FY 05. This resulted primarily from converting investments into cash to provide cash for various plant fund projects and the sale (in FY 04) of funds invested in the Trust Fund Bond Pool.

DISCUSSION OF SIGNIFICANT PENDING ECONOMIC AND FINANCIAL ISSUES

The issues we view as significant pending economic or financial issues for the four campuses of the University are:

- As of June 30, 2006, the University has undertaken a number of building construction projects. Those projects include an addition to the School of Pharmacy and Allied Health Sciences Skaggs Building (estimated cost of \$14 million), a new journalism school building, Anderson Hall (estimated cost of \$11.4 million) and a new building to house the Helena College of Technology (estimated cost of \$7.5 million). In addition, five other major construction projects were in the planning stage. The first was the Multi Disciplinary Research Building (not yet named; estimated cost of \$12.0 million), and the second was the Gilkey Executive Education Center (estimated cost of \$5.1 million). The third was the MBMG/Petroleum Building on the Montana Tech campus (estimated cost of \$14.4 million), the fourth was a planned expansion of the law school on the Missoula campus (estimated cost of \$5.5 million) necessitated in part, by accreditation requirements and the fifth, the expansion/upgrade of the steam distribution system on the Missoula campus (estimated cost \$8.9 million).
- A concern for the University is its increasing dependence on tuition, and a projected decline in the number of high school graduates in Montana over the next 10 years. While tuition at the University is in the moderated range when compared to other institutions, even a moderate level of tuition is unaffordable for many Montana families. Compounding this problem is a decline in federal need based financial aid. The University has a number of initiatives to improve both access and retention of Montana students who wish to pursue higher education. The University will also continue to encourage more need-based assistance at the State level to help increase the overall support provided to economically disadvantaged students.
- Utility costs continue to increase at a much faster pace than other University operating costs, particularly natural gas rates paid over the last several years. To help mitigate the effects of rising prices the Board of Regents allowed the University to generate additional revenue to cover the increased cost through a utility surcharge assessed to the students of the various campuses for the 2006/2007 biennium. At this time, the University does not plan to continue assessing students a utility surcharge for the 2008/2009 biennium. The current natural gas contract expires in June of 2007, and it is estimated that rates paid under the new 2 year contract will increase by at least 28%.
- The University must continue to improve the efficiency and effectiveness of its operations through an on going assessment of its business practices as it faces possible lower enrollments, continued erosion of state support and rising costs. A number of recent initiatives have generated additional financial support, reduced operating costs and/or improved services to students.

The University of Montana
A Component Unit of the State of Montana
Consolidated Statements of Net Assets
As of June 30, 2006 and 2005

	2006	2005*
ASSETS		
Current Assets		
Cash and cash equivalents (note 3)	\$ 84,427,472	\$ 57,171,142
Securities lending collateral	836,492	730,270
Investments	1,801,141	8,015,414
Accounts and grants receivable, net	4,452,194	4,093,648
Due from Federal government	7,803,785	8,618,405
Due from primary government	1,669,790	1,006,617
Due from other State of Montana component units	428,548	458,222
Loans to students, net	1,564,564	1,584,127
Inventories	1,759,980	1,731,412
Prepaid expenses and deferred charges	1,661,508	1,620,262
Total current assets	\$106,405,474	\$ 85,029,519
Noncurrent Assets		
Restricted cash and cash equivalents	\$ 204,516	\$ 854,950
Endowment investments	17,390,643	15,246,253
Other long term investments	6,075,053	5,799,571
Loans to students, net	9,664,456	9,317,013
Bond issuance costs	2,269,912	2,003,906
Capital assets, net	248,272,379	239,743,728
Total Noncurrent Assets	\$283,876,959	\$272,965,421
Total Assets	\$390,282,433	\$357,994,940
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 14,527,916	\$ 18,814,704
Due to Federal government	150	23,299
Due to primary government	815,573	1,049,965
Due to other State of Montana component units	24,027	190,423
Securities lending liability	836,492	730,270
Student and other deposits	2,290,565	1,994,765
Deferred revenue	12,503,336	10,599,640
Accrued compensated absences	7,763,180	7,133,956
Current portion of long-term obligations	5,725,342	4,923,326
Total Current Liabilities	\$ 44,486,581	\$ 45,460,348
Noncurrent Liabilities		
Accrued compensated absences	\$ 11,596,372	\$ 11,102,128
Long term obligations	146,509,434	132,381,231
Advances from primary government	5,466,479	5,457,429
Due to Federal Government	9,875,660	9,696,369
Derivative financial instrument	2,094,500	-
Total Noncurrent Liabilities	\$175,542,445	\$158,637,157
Total Liabilities	\$220,029,026	\$204,097,505
NET ASSETS		
Invested in capital assets, net of related debt	\$119,572,500	\$105,948,125
Restricted for:		
Nonexpendable		
Endowments	15,958,648	13,867,419
Loans	1,874,706	1,816,068
Expendable		
Loans	1,698,933	1,771,860
Scholarships, research, instruction, and other	3,850,034	3,536,658
Unrestricted	27,298,586	26,957,305
Total Net Assets	\$170,253,407	\$153,897,435
Total Liabilities & Net Assets	\$390,282,433	\$357,994,940

* Restated

The accompanying notes are an integral part of these financial statements.

The University of Montana

A Component Unit of the State of Montana

University Component Units - Combined Statements of Financial Position

As of June 30 or December 31, 2006 and 2005

	2006	2005
ASSETS		
Cash and cash equivalents	\$ 9,646,463	\$ 3,849,161
Short-term investments	10,081,974	15,489,708
Accrued dividends and interest	354,288	540,951
Investments	146,820,969	132,559,823
Contributions receivable, net	17,685,297	15,877,029
Contracts and notes receivable, net	31,393	135,807
Student loans and other receivables	186,619	230,759
Depreciable assets, net of accumulated depreciation	4,949,334	4,966,512
Other assets	518,232	522,108
Total Assets	\$ 190,274,569	\$ 174,171,858
LIABILITIES		
Accounts payable	\$ 58,417	\$ 458,353
Accrued expenses	27,150	38,934
Compensated absences	168,944	140,555
Note payable - bank	469,614	572,053
Note payable - long-term	75,712	80,934
Liabilities to external beneficiaries	2,786,406	2,401,751
Custodial funds	19,582,375	16,721,398
Other liabilities	316,896	328,145
Total Liabilities	\$ 23,485,514	\$ 20,742,123
NET ASSETS		
Net assets - unrestricted	10,450,806	9,559,281
Net assets - temporarily restricted	63,864,257	56,482,237
Net assets - permanently restricted	92,473,992	87,388,217
Total Net Assets	\$ 166,789,055	\$ 153,429,735
Total Liabilities & Net Assets	\$ 190,274,569	\$ 174,171,858

The University of Montana
A Component Unit of the State of Montana
Consolidated Statements of Revenues, Expenses
and Changes in Net Assets
For the Years Ended June 30, 2006 and 2005

	2006	2005
OPERATING REVENUES:		
Tuition and fees (net of scholarship allowances in 2006 and 2005 of \$20,956,428 and \$18,113,939, respectively; 2006 and 2005 revenues of \$10,688,751 and \$10,108,176, respectively, are pledged)	\$ 87,926,316	\$ 83,075,215
Federal grants and contracts	64,650,157	65,670,978
State and local grants and contracts	8,913,433	7,418,190
Nongovernmental grants and contracts	4,984,611	3,994,410
Grant and contract facilities and administrative cost allowances	9,793,983	10,422,866
Sales and services of educational departments (2006 and 2005 revenues of \$3,562,413 and \$3,947,188, respectively, are pledged)	12,347,010	12,277,616
Auxiliary enterprises charges:		
Residential life (net of scholarship allowances in 2006 and 2005 of \$864,759 and \$1,090,217, respectively; 2006 and 2005 revenues of \$11,934,989 and \$11,106,268, respectively, are pledged)	11,989,439	11,126,266
Food services (net of scholarship allowances in 2006 and 2005 of \$864,759 and \$1,090,216, respectively; 2006 and 2005 revenues of \$9,776,150 and \$9,357,684 respectively, are pledged)	9,958,357	10,072,945
Other auxiliary revenues (2006 and 2005 revenues of \$9,692,789 and \$8,624,861, respectively, are pledged)	10,924,707	8,879,010
Interest earned on loans to students	47,480	29,638
Other operating revenues	5,482,745	5,209,668
Total operating revenues	\$227,018,238	\$218,176,802
OPERATING EXPENSES:		
Compensation and employee benefits	\$185,882,032	\$175,849,265
Other (note 18)	73,785,705	72,730,894
Scholarships and fellowships	15,282,299	15,696,669
Depreciation and amortization	16,710,382	16,068,885
Total operating expenses	\$291,660,418	\$280,345,713
OPERATING LOSS	\$ (64,642,180)	\$ (62,168,911)
NON-OPERATING REVENUES (EXPENSES):		
State appropriations	\$ 62,073,958	\$ 56,701,381
Land grant revenues (revenues are pledged)	1,452,867	1,739,645
Private gifts	15,575,156	9,726,707
Investment income (2006 and 2005 revenues of \$2,005,526 and \$738,055, respectively, are pledged)	5,184,299	2,570,550
Interest expense	(7,376,448)	(6,599,611)
Net non-operating revenues	\$ 76,909,832	\$ 64,138,672
INCOME BEFORE OTHER REVENUES (EXPENSES)	\$ 12,267,652	\$ 1,969,761
OTHER REVENUES (EXPENSES):		
Capital grants and gifts	\$ 3,063,894	\$ 2,377,702
Additions to permanent endowments	1,562,500	3,437,500
Loss on disposal of capital assets	(538,074)	-
Total other revenues	\$ 4,088,320	\$ 5,815,202
Net increase in net assets	\$ 16,355,972	\$ 7,784,963
NET ASSETS:		
Net assets - beginning of year	\$153,897,435	\$146,112,472
Net assets - end of year	\$170,253,407	\$153,897,435

The University of Montana

A Component Unit of the State of Montana

University Component Units - Combined Statement of Activities

For the Years Ended June 30 or December 31, 2006 and 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted	2006 Total	2005 Total (memo)
REVENUES:					
Contributions	\$ 1,514,840	\$ 16,428,098	\$ 5,037,433	\$ 22,980,371	\$ 22,660,012
Interest and dividend income	525,727	2,846,679	-	3,372,406	3,241,895
Net realized and unrealized gain (loss) on investments	36,258	8,424,993	103,665	8,564,916	4,532,191
Support received from university	322,800	-	-	322,800	382,600
Special events	497,163	324,833	240	822,236	944,079
Other income	18,867	692,394	-	711,261	702,455
Net assets released from restrictions	20,705,337	(20,705,337)	-	-	-
Total revenues	\$ 23,620,992	\$ 8,011,660	\$ 5,141,338	\$ 36,773,990	\$ 32,463,232
EXPENSES:					
Program services					
Academic and institutional	\$ 6,419,008	\$ -	\$ -	\$ 6,419,008	\$ 5,799,927
Capital expenses	7,218,676	-	-	7,218,676	2,229,262
Scholarships and awards	4,607,768	-	-	4,607,768	4,303,272
Total program services	\$ 18,245,452	\$ -	\$ -	\$ 18,245,452	\$ 12,332,461
Operating expenses					
Fundraising efforts	\$ 2,544,619	\$ -	\$ -	\$ 2,544,619	\$ 2,410,363
General and administrative	1,364,088	-	-	1,364,088	1,212,998
Investment management costs	186,755	-	-	186,755	160,425
Other miscellaneous	383,190	-	-	383,190	134,149
Total operating expenses	\$ 4,478,652	\$ -	\$ -	\$ 4,478,652	\$ 3,917,935
Change in net assets before nonoperating items	\$ 896,888	\$ 8,011,660	\$ 5,141,338	\$ 14,049,886	\$ 16,212,836
NON-OPERATING REVENUES (EXPENSES):					
Payments to beneficiaries and change in liabilities due to external beneficiaries	(153)	(690,413)	-	(690,566)	(321,927)
Adjustments	(5,210)	60,773	(55,563)	-	(4,961,155)
Change in net assets	\$ 891,525	\$ 7,382,020	\$ 5,085,775	\$ 13,359,320	\$ 10,929,754
Net assets, beginning of year	9,559,281	56,482,237	87,388,217	153,429,735	142,499,981
Net assets, end of year	\$ 10,450,806	\$ 63,864,257	\$ 92,473,992	\$ 166,789,055	\$ 153,429,735

The University of Montana

A Component Unit of the State of Montana

Consolidated Statements of Cash Flows

For the Years Ended June 30, 2006 and 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	\$ 88,030,548	\$ 82,713,310
Federal grants and contracts	66,055,453	66,293,671
State grants and contracts	9,083,207	7,454,744
Nongovernmental grants and contracts	5,079,552	4,014,094
Grant and contract facilities and administrative cost allowances	9,793,983	10,422,866
Sales and services of educational activities	12,628,252	12,016,912
Auxiliary enterprises charges	32,826,195	30,212,820
Interest earned on loans to students	76,751	105,497
Other operating receipts	5,734,091	5,153,745
Payments to employees for salaries and benefits	(188,161,888)	(174,511,617)
Operating expenses	(74,555,734)	(72,369,164)
Payments for scholarships and fellowships	(15,282,299)	(15,696,669)
Loans made to students	(3,735,931)	(2,909,678)
Loan payments received	3,238,467	3,152,868
Net Cash Used by Operating Activities	\$ (49,189,353)	\$ (43,946,601)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	\$ 62,073,958	\$ 56,701,381
Land Grants	1,452,867	1,739,645
Private Gifts	15,565,314	9,726,708
Additions to permanent endowments	1,572,425	3,437,500
Net Cash Provided by Noncapital Financing Activities	\$ 80,664,564	\$ 71,605,234
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	\$ (3,638,219)	\$ (6,925,291)
Proceeds from sales of investments	7,771,747	1,460,560
Earnings received on investments	4,845,171	2,405,550
Net Cash Provided by (Used for) Investing Activities	\$ 8,978,699	\$ (3,059,181)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash paid for capital assets	\$ (22,355,330)	\$ (13,843,273)
Proceeds from the sale of capital assets	86,414	212,199
Proceeds from notes payable and advances from primary government	484,835	1,333,876
Principal paid on notes payable, advance from primary government, and capital leases	(1,270,725)	(1,324,724)
Principal paid on bonds payable	(5,010,000)	(3,235,000)
Principal and premium paid to defease revenue bonds	(11,259,479)	-
Proceeds from issuance of revenue bonds	31,205,748	-
Proceeds from swaption contract	2,094,500	-
Bond issuance costs paid on new issue	(670,417)	-
Interest paid on capital debt and leases	(7,153,560)	(7,313,944)
Net Cash Used by Capital and Related Financing Activities	\$ (13,848,014)	\$ (24,170,866)
Net Increase in Cash and Cash Equivalents	\$ 26,605,896	\$ 428,586
Cash and Cash Equivalents, Beginning of Year	\$ 58,026,092	\$ 57,597,506
Cash and Cash Equivalents, End of Year	\$ 84,631,988	\$ 58,026,092

The University of Montana
A Component Unit of the State of Montana
Consolidated Statements of Cash Flows

For the Years Ended June 30, 2006 and 2005

(Continued)

	2006	2005
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used By) Operating Activities:		
Operating loss:	\$ (64,642,180)	\$ (62,168,911)
Adjustments to reconcile operating loss to net cash used by operating activities		
Depreciation and amortization expense	16,710,382	16,068,885
Other amortization expense	528,415	162,832
Changes in assets and liabilities:		
Accounts receivable	(177,425)	(338,717)
Loans to students	(327,880)	403,883
Inventories	(28,568)	(35,540)
Prepaid expenses and deferred charges	(41,246)	386,254
Accounts payable and accrued expenses	(4,713,024)	673,489
Deferred revenue	1,903,695	433,149
Student and other deposits	295,719	(315,681)
Due to federal government	179,291	224,123
Compensated absences	1,123,468	559,633
Net Cash Used by Operating Activities	\$ (49,189,353)	\$ (43,946,601)
Noncash Investing, Noncapital Financing, and Capital and Related Financing Transactions		
Fixed assets acquired by incurring capital lease obligations	\$ (444,297)	\$ (123,996)
Change in fair value of investments recognized as a component of interest income	339,128	164,997
Fixed assets acquired from Capital grants and donations	3,063,893	2,236,786
Reconciliation of Cash and Cash Equivalent to the Statement of Net Assets		
Cash and cash equivalents classified as current assets	\$ 84,427,472	\$ 57,171,142
Cash and cash equivalents classified as noncurrent assets	204,516	854,950
Total Cash and Cash Equivalents, End of Year	\$ 84,631,988	\$ 58,026,092

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

THE UNIVERSITY OF MONTANA

A COMPONENT UNIT OF THE STATE OF MONTANA

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

NOTE 1 – ORGANIZATION, REPORTING ENTITY AND BASIS OF PRESENTATION

▪ ORGANIZATION

The University of Montana (University) is a component unit of the State of Montana (State) with an enrollment of approximately 18,000 students on its four campuses. The State of Montana Board of Regents (Board of Regents) is appointed by the Governor of the State and has oversight responsibility with respect to the University. The State allocates and allots funds to each campus separately and requires that the funds be maintained accordingly.

▪ REPORTING ENTITY

The accompanying consolidated financial statements include all activities of the four campuses of the University, the Forestry Experiment Station and the Montana Bureau of Mines. The four campuses of the University are The University of Montana – Missoula, Montana Tech of The University of Montana, which is located in Butte, The University of Montana – Western, which is located in Dillon, and The University of Montana - Helena College of Technology.

GASB Statement No. 39, “Determining Whether Certain Organizations Are Component Units, an Amendment of GASB Statement No. 14” requires that a legally tax exempt organization should be reported as a component unit of a reporting entity if the economic resources received or held by these organizations are entirely or virtually entirely for the direct benefit of the reporting entity or its component units, and the reporting entity is entitled to, or has the means to otherwise access, a majority of the economic resources received or held by the separate organization. The resources of the separate organization must also be significant to the reporting entity. The University has established a threshold minimum of 1 percent of consolidated net assets or 1 percent of consolidated revenues as an additional requirement for inclusion of an organization as a component unit in its financial statements. In addition, other organizations should be evaluated for inclusion if they are closely related to, or financially integrated with, the reporting entity. All component units and other related organizations will be tested and evaluated on an annual basis for inclusion under GASB No. 39. Accordingly, the University has identified and will present the combined activities of four component units, The University of Montana Foundation, The Montana Tech Foundation, The University of Montana - Western Foundation, and the Montana Grizzly Scholarship Association. For further discussion of accounting for component units, see Consolidated Financial Statements Note 19, “Accounting for Component Units.”

The University is considered a component unit of the State of Montana under GASB No. 14. As such, the financial statements for the University are included as a component part of the State of Montana Basic Financial Statements, which are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

The University, as a political subdivision of the State of Montana, is excluded from Federal income taxes under Section 115(1) of the Internal Revenue Code, as amended. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

▪ BASIS OF PRESENTATION

The financial statements have been prepared in accordance with generally accepted accounting principles, as prescribed by the GASB. Under GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments” and GASB No. 35, “Basic Financial Statements and Management’s Discussion and Analysis for Public Colleges and Universities,” the University is required to present a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows. All significant intra-entity transactions have been eliminated upon consolidation.

Notes to the Consolidated Financial Statements (continued)

Also, in accordance with GASB Statements No. 39, the combined statement of financial position and statement of activities of the four component units referred to above are separately presented following the respective University financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, the University's consolidated financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

The University had the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The University elected to not apply FASB pronouncements issued after the applicable date.

▪ USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

▪ CASH EQUIVALENTS

For purposes of the Consolidated Statement of Cash Flows, the University considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Funds invested in Guaranteed Investment Contracts (GICs) and in the Short Term Investment Pool (STIP) with the Montana Board of Investments are considered cash equivalents.

▪ INVESTMENTS

The University accounts for its investments at fair value in accordance with GASB No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools." Investment income is recorded on the accrual basis. All investment income, including changes in unrealized gain (loss) on the carrying value of investments, is reported as a component of investment income.

▪ ACCOUNTS AND GRANTS RECEIVABLE

Accounts receivable consists of tuition and fee charges to students and to auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also includes amounts due from the federal government and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable is recorded net of estimated uncollectible amounts.

INVENTORIES

Inventories are comprised of consumable supplies, food items and items held for resale or recharge within the University. The larger inventories are valued using the moving-average method. Other inventories are valued using First In First Out (FIFO) or specific identification methods.

▪ CASH AND SHORT-TERM INVESTMENTS

Cash and investments that are externally restricted to make debt service payments, or by a donor or outside agency prohibiting the expenditure of principal and possibly earnings, are classified as non-current assets in the Consolidated Statement of Net Assets.

CAPITAL ASSETS

Capital assets are stated at cost or fair market value at date of purchase or donation. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the asset are

capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred. Buildings, building improvements and land improvements, and infrastructure are capitalized when acquisition costs equal or exceed \$25,000 and \$500,000, respectively. Equipment is capitalized when acquisition costs equal or exceed \$5,000.

Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets as follows: buildings - 40 years; land improvements and infrastructure - 20 and 40 years, respectively; library books - 8 years; and equipment- 3 to 10 years. Historically, the University has capitalized all artwork subject to applicable capitalization policies at the time of donation or purchase. The University has elected to continue to capitalize artwork subject to the current threshold, but without recording depreciation on those items.

DEFERRED REVENUE

Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

COMPENSATED LEAVE

Eligible University employees earn eight hours sick leave and ten hours annual leave for each month worked. The accrual rate for annual leave increases with length of service. The maximum annual leave that eligible employees may accumulate is two hundred percent of their annual accrual. Sick leave may accumulate without limitation. Twenty-five percent of accumulated sick leave earned after July 1, 1971, and one hundred percent of accumulated annual leave, if not used during employment, is paid upon termination.

■ NET ASSETS

The University's net assets are categorized as follows:

- **Invested in capital assets, net of related debt** - Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted, nonexpendable** - Net assets subject to externally imposed stipulations that the University maintain those assets permanently. Such assets include the University's permanent endowment funds.
- **Restricted, expendable** - Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted** - Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents, or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

■ CLASSIFICATION OF REVENUES

The University has classified its revenues as either operating or non-operating revenues according to the following criteria:

- **Operating revenue** - Operating revenues include activities that have the characteristics of exchange transactions, such as (1) student tuition and fees, net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most federal, state and local grants and contracts and federal appropriations, and (4) interest on institutional student loans.
- **Non-operating revenues** - Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB No. 9, "Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting," and GASB No. 34, "Basic Financial Statements and Management Discussion and Analysis for State and Local

Notes to the Consolidated Financial Statements (continued)

Governments.” Types of revenue sources that fall into this classification are state appropriations and investment income.

■ USE OF RESTRICTED REVENUES

When the University maintains both restricted and unrestricted funds for the same purpose, the order of use of such funds is determined on a case-by-case basis. Restricted funds remain classified as restricted until they have been expended.

■ SCHOLARSHIP DISCOUNTS AND ALLOWANCES

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statements of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are generated by the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs, are recorded as either operating or non-operating revenues in the University's consolidated financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

■ RECLASSIFICATIONS

In order to make certain prior year amounts comparable to the current year presentation on the Statement of Net Assets, securities lending collateral and related securities lending liability were reclassified as a current asset and current liability, respectively.

NOTE 3 – CASH EQUIVALENTS AND INVESTMENTS

CASH EQUIVALENTS

Cash equivalents consist of cash invested in Guaranteed Investment Contracts (GICs) with Transamerica Occidental, and in the STIP with the Montana Board of Investments. Amounts held in cash equivalents at June 30, 2006 and 2005 were \$55,095,471 and \$35,046,331, respectively. At June 30, 2006, \$21,839,549 of unexpended proceeds from the issuance of Facility Improvement Revenue Bonds, were invested in GIC accounts and is included in the total cash equivalents of \$55,095,471. STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle." The STIP portfolio may include asset-backed securities, commercial paper, corporate and government securities, repurchase agreements and variable rate, or floating rate, instruments to provide diversification and a competitive rate of return. Investments in STIP and GICs may be withdrawn by the University on demand, and as such, are classified as cash equivalents.

■ INVESTMENTS

Investments consisted of the following at June 30, 2006 and 2005:

Security Type	Fair Value		Effective Duration at June 30, 2006*	Credit Quality Rating at June 30, 2006***
	2006	2005		
U.S. Government Indirect – Backed	\$ 3,350,033	\$ 8,650,289	1.60	NR
U.S. Government Direct – Backed	219,292	652,133	1.72	NR
Trust Fund Bond Pool (TFBP)	5,507,471	6,013,294	4.97**	NR
Montana Domestic Equity Pool (MDEP)	1,110,293	1,035,112	Not Applicable	NR
Foundation Pooled Investments	14,626,407	12,447,287	Not Applicable	NR
Certificates of Deposits	258,342	263,123	.93	NR
Total investments	\$ 25,266,837	\$ 29,061,238		
Securities Lending Collateral Investment Pool	\$ 836,492	\$ 730,270		

*See Interest Rate Risk under the Investment Risks disclosure included in this note.

**Effective duration for TFBP is for the entire portfolio.

***NR indicates security investment unrated for credit quality type.

Investments held by the University at June 30, 2006 and 2005 are described further in the paragraphs below.

U.S. Government Securities

U.S. Government securities consist of bond trustee funds managed by U.S. Bank. The U.S. Government securities portfolio includes Treasury securities or other Federal agency securities, and federal money market accounts. All of the securities were registered under the nominee's name (U.S. Bank) on behalf of the University.

Montana Board of Investments Pools

The University is a participant in certain internal investment pools administered by the Montana Board of Investments (MBOI). MBOI purchases investments for each portfolio in accordance with the statutorily mandated "Prudent Expert Principle." The University was invested in the following internal investment pools at June 30, 2006 and 2005:

Montana Domestic Equity Pool (MDEP)

The MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts (ADR's) and equity derivatives. ADR's are receipts issued by a U.S. depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. Equity derivatives "derive" their value from other equity instruments such as futures and options.

Trust Funds Bond Pool (TFBP)

The TFBP portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed, and Yankee securities. The TFBP portfolio includes securities classified as corporate, foreign government bonds, municipals, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The TFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities.

The University Foundation Pools

This pool consists of endowment funds held in a common investment pool administered by the University of Montana and Montana Tech Foundations.

Certificates of deposit

Certificates of deposit serve as collateral for loans made to students with disabilities for the purchase of specialized equipment necessary to complete their education. The certificate of deposit, including interest earned, is reinvested upon maturity.

Securities lending transactions

Under the provisions of state statutes, the Board of Investments, via a Securities Lending Authorization Agreement, has authorized the custodial bank, State Street Bank and Trust, to lend the Board of Investment's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board of Investments receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board of Investments retains all rights and risks of ownership during the loan period.

Notes to the Consolidated Financial Statements (continued)

During the years ending June 30, 2006 and 2005, the Board of Investments and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified-plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board of Investment's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board of Investments could not determine. At June 30, 2006 and 2005, the Board of Investments had no credit risk exposure to borrowers.

Investment risks

Effective June 30, 2005, the University implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, "Deposit and Investment Risk Disclosures."

Investment risks associated with the University's investments are described in the following paragraphs:

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB 40, the State of Montana has selected the effective duration method to disclose interest rate risk. Duration is a measure of a debt's exposure to fair value changes from changing interest rates. It uses the present value of the cash flows from the investment, weighting those cash flows as a percentage of the investment's full price. The University does not have a formal investment policy for interest rate risk.

Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The University does not have a formal investment policy for credit risk. With the exception of the U.S. government securities, all STIP securities and TFBP fixed income instruments have credit risk as measured by major credit rating services. The MBOI policy requires that STIP securities have the highest investment grade rating in the short term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSRO's include Standard and Poor's, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch. The Board of Investment's policy requires TFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services.

U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The University does not have a formal investment policy for custodial credit risk. As of June 30, 2006 and 2005, all STIP, MDEP and TFBP securities were registered in the nominee name for the MBOI and held in the possession of the Board's custodial bank, State Street Bank. According to the STIP Investment Policy, "repurchase agreements require electronic delivery of U.S. Government Treasury collateral, priced at 102 percent of market value, to the designated State of Montana Federal Reserve Bank account." The MDEP's BGI S&P 500 Equity Index Fund A, S&P 400 MidCap Equity Index Fund and the DFA Small Cap Subtrust are registered in the name of the Montana Board of Investments. The TFBP's State Street repurchase agreement was purchased in the name of the State of Montana Board of Investments.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The University does not have a formal policy for concentration of credit risk. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk

requirement. MDEP investments in pooled investments, such as the BGI Equity Index and DFA Small Cap Subtrust investments, are also excluded from this requirement. As of June 30, 2006 and 2005, there were no single issuer investments that exceeded 5% of the MDEP portfolio. According to the TFBP Investment Policy, “with the exception of U.S. government indirect-backed (agency) securities, additional TFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase”. As of June 30, 2006 and 2005, the TFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 7.75% and 8.19%, respectively.

Land grant earnings

In 1881, the Congress of the United States granted land to the State of Montana for the benefit of the state’s universities and colleges. The Enabling Act of 1889 granted 46,563 acres to Missoula, 100,000 acres to Montana Tech and 50,000 acres to Western Montana College. Under provisions of the grants, proceeds from the sale of land and land assets, together with proceeds from the sale of timber, oil royalties and other minerals, must be reinvested, and constitute, along with the balance of unsold land, a perpetual trust fund. The grant is administered as a trust by the State Land Board, which holds title and has the authority to direct, control, lease, exchange and sell these lands. The University, as a beneficiary, does not have title to the assets resulting from the grant, only a right to the earnings generated. The University’s share of the trust earnings was \$1,452,867 and \$1,739,645 for the years ended June 30, 2006 and 2005, respectively. These earnings are currently pledged to the Series C 1995, Series E 1998, Series F 1999, Series G 2002, Series H 2003, Series I 2004, and Series J 2005 revenue bonds.

The University’s land grant assets are not reflected in the consolidated financial statements, but are included as a component of the State of Montana Basic Financial Statements that are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

NOTE 4 – INVENTORIES

Inventories consisted of the following at June 30, 2006 and 2005:

	2006	2005
Bookstore	\$ 595,787	\$ 601,788
Food services	120,306	104,635
Facilities services	718,470	703,795
Other	325,417	321,194
	<u>\$ 1,759,980</u>	<u>\$ 1,731,412</u>

NOTE 5 – ACCOUNTS AND GRANTS RECEIVABLE

Accounts Receivable consisted of the following at June 30, 2006 and 2005:

	2006	2005
Student tuition and fees	\$ 1,545,029	\$ 1,425,714
Auxiliary enterprises and other operating activities	1,355,001	1,217,042
Federal and private grants and contracts	1,392,136	1,109,827
Other	440,384	594,935
	<u>4,732,550</u>	<u>4,347,518</u>
Less: allowance for doubtful accounts	208,356	253,870
	<u>\$ 4,452,194</u>	<u>\$ 4,093,648</u>

Notes to the Consolidated Financial Statements (continued)

NOTE 6 – LOANS RECEIVABLE

Student loans made under the Federal Perkins Loan Program constitute the majority of the University's loan receivable balances. Included in non-current liabilities as of June 30, 2006 and 2005 are \$9,875,660 and \$9,696,369, respectively, that would be refundable to the Federal Government should the University choose to cease participation in the Federal Perkins Loan program.

The Federal portion of interest income and loan program expenses is shown as additions to and deductions from the amount due to the Federal government, and not as operating transactions, in the Consolidated Statement of Net Assets.

NOTE 7 – CAPITAL ASSETS

The following tables present the changes in capital assets for the years ended June 30, 2006 and 2005, respectively.

For the year ended June 30, 2006:

	Beginning Balance	Additions	Deletions	Transfers and Other Changes	Ending Balance
Capital assets not being depreciated:					
Land	\$ 7,125,781	\$ -	\$ -	\$ -	\$ 7,125,781
Capitalized Collections	15,270,723	190,694	-	-	15,461,417
Construction in progress	13,365,371	18,224,036	-	(1,897,698)	29,691,709
	35,761,875	18,414,730	-	(1,897,698)	52,278,907
Other capital assets:					
Buildings	203,800,450	-	-	-	203,800,450
Building improvements	126,111,619	-	-	1,392,857	127,504,476
Furniture and equipment	47,834,423	6,084,894	7,485,658	(89,191)	46,344,468
Land improvements	12,220,369	-	-	399,012	12,619,381
Livestock	34,197	-	-	-	34,197
Library materials	47,996,834	1,404,226	111,948	-	49,289,112
	437,997,892	7,489,120	7,597,606	1,702,678	439,592,084
Less accumulated depreciation for:					
Buildings	87,113,683	4,567,001	-	-	91,680,684
Building improvements	65,614,368	6,599,871	-	-	72,214,239
Furniture and equipment	32,930,955	3,229,243	6,926,560	-	29,233,638
Livestock	3,603	4,082	-	-	7,685
Land improvements	7,879,127	341,791	-	-	8,220,918
Library materials	41,198,807	1,657,467	111,947	-	42,744,327
	234,740,543	16,399,455	7,038,507	-	244,101,491
Other capital assets, net	203,257,349	(8,910,335)	559,099	1,702,678	195,490,593
Intangible assets	724,504	89,302	-	(310,927)	502,879
Total capital assets, net					
Capital Asset Summary:					
Capital assets not being depreciated	\$ 35,761,875	\$ 18,414,730	\$ -	\$ (1,897,698)	\$ 52,278,907
Other capital and intangible assets	438,722,396	7,578,422	7,597,606	1,391,751	440,094,963
	474,484,271	25,993,152	7,597,606	(505,947)	492,273,870
Less: accumulated depreciation	234,740,543	16,399,455	7,038,507	-	244,101,491
Total capital assets, net	\$ 239,743,728	\$ 9,593,697	\$ 559,099	\$ (505,947)	\$ 248,272,379

For the year ended June 30, 2005:

	Beginning Balance	Additions	Deletions	Transfers and Other Changes	Ending Balance
Capital assets not being depreciated:					
Land	\$ 7,000,781	\$ -	\$ -	\$ 125,000	\$ 7,125,781
Capitalized Collections	14,792,998	477,725	-	-	15,270,723
Construction in progress	24,093,859	10,583,647	412,342	(20,899,793)	13,365,371
	45,887,638	11,061,372	412,342	(20,774,793)	35,761,875
Other capital assets:					
Buildings	186,305,169	730,495	-	16,764,786	203,800,450
Building improvements	124,474,478	-	-	1,637,141	126,111,619
Furniture and equipment	47,272,656	3,478,468	3,284,403	367,702	47,834,423
Land improvements	9,368,091	426,310	-	2,425,968	12,220,369
Livestock	18,750	15,447	-	-	34,197
Library materials	46,528,294	1,468,540	-	-	47,996,834
	413,967,438	6,119,260	3,284,403	21,195,597	437,997,892
Less accumulated depreciation for:					
Buildings	82,903,742	4,209,941	-	-	87,113,683
Building improvements	59,063,075	6,551,293	-	-	65,614,368
Furniture and equipment	32,686,712	3,054,539	2,823,120	12,824	32,930,955
Livestock	625	2,978	-	-	3,603
Land improvements	7,605,256	273,871	-	-	7,879,127
Library materials	39,455,107	1,705,260	-	38,440	41,198,807
	221,714,517	15,797,882	2,823,120	51,264	234,740,543
Other capital assets, net	192,252,921	(9,678,622)	461,283	21,144,333	203,257,349
Intangible assets	808,783	186,723	-	(271,002)	724,504
Total capital assets, net	\$ 238,949,342	\$ 1,569,473	\$ 873,625	\$ 98,538	\$ 239,743,728
Capital Asset Summary:					
Capital assets not being depreciated	\$ 45,887,638	\$ 11,061,372	\$ 412,342	\$ (20,774,793)	\$ 35,761,875
Other capital and intangible assets	414,776,221	6,305,983	3,284,403	20,924,595	438,722,396
	460,663,859	17,367,355	3,696,745	149,802	474,484,271
Less: accumulated depreciation	221,714,517	15,797,882	2,823,120	51,264	234,740,543
Total capital assets, net	\$ 238,949,342	\$ 1,569,473	\$ 873,625	\$ 98,538	\$ 239,743,728

NOTE 8 – LONG – TERM LIABILITIES

The following tables present the changes in long-term liabilities for the years ended June 30, 2006 and 2005, respectively:

For the year ended June 30, 2006

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Bonds, notes and capital leases					
Revenue bonds payable, net	\$ 134,785,340	\$ 31,430,847	\$ 16,208,412	\$ 150,007,775	\$ 5,105,000
Notes payable	2,020,728	-	429,764	1,590,964	387,096
Capital leases payable	498,489	444,297	306,749	636,037	233,246
	137,304,557	31,875,144	16,944,925	152,234,776	5,725,342

Notes to the Consolidated Financial Statements (continued)

Other long-term liabilities

Accrued compensated absences	18,236,084	8,525,259	7,401,791	19,359,552	7,763,180
Advances from primary government	5,890,671	484,835	534,211	5,841,295	374,816
Due to Federal Government	9,696,369	179,291	-	9,875,660	-
Derivative financial instrument	-	2,094,500	-	2,094,500	-
	33,823,124	11,283,885	7,936,002	37,171,007	8,137,995
Total long-term liabilities	\$ 171,127,681	\$ 43,159,029	\$ 24,880,927	\$ 189,405,783	\$ 13,863,338

For the year ended June 30, 2005

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Bonds, notes and capital leases					
Revenue bonds payable, net	\$ 137,919,669	\$ 213,859	\$ 3,348,188	\$ 134,785,340	\$ 4,340,000
Notes payable	2,076,623	470,000	525,895	2,020,728	380,426
Capital leases payable	826,792	123,996	452,299	498,489	202,900
	140,823,084	807,855	4,326,382	137,304,557	4,923,326
Other long-term liabilities					
Accrued compensated absences	17,676,451	8,045,971	7,486,338	18,236,084	7,133,956
Advances from primary government	5,373,322	863,874	346,525	5,890,671	433,242
Due to Federal Government	9,472,246	224,123	-	9,696,369	-
	32,522,019	9,133,968	7,832,863	33,823,124	7,567,198
Total long-term liabilities	\$ 173,345,103	\$ 9,941,823	\$ 12,159,245	\$ 171,127,681	\$ 12,490,524

LONG-TERM LIABILITIES

Long-term liabilities include:

- capital lease obligations, principal amounts of bonds payable, revenue bonds payable, and notes payable with contractual maturities greater than one year;
- estimated amounts for accrued compensated absences and other liabilities that will not be paid within the next fiscal year; and
- other liabilities that, although payable within one year, are to be paid from funds that are classified as non-current assets.

Interest Rate Exchange Agreement

In August, 2005 the University entered into a forward SWAP agreement ("swaption") with Wachovia Bank, NA ("counterparty") to hedge the interest rate risk associated with the potential future issuance of variable-rate revenue bonds. In exchange, the University received \$2,094,500 from the counterparty. A portion of the payment was consideration for the estimated present value of the fixed rate payable under the agreement upon execution of the swaption. The swaption gives the counterparty the right to require that the University execute a floating to fixed swap in May 2010, based on a notional amount of \$47,000,000. Should the counterparty exercise its option, the University would expect to issue Series K 2010 taxable, variable rate bonds at the \$47,000,000 notional amount of the swap. The intention of the University in entering into the swaption is to refund its outstanding Series F 1999 Revenue Bonds and lower the cost of its borrowing.

Terms – The counterparty has the right to exercise the swap on May 15, 2010, the call date of the Series F 1999 Revenue Bonds. If the swaption is exercised it will also become effective on May 15, 2010. Under terms of the swap, the University will pay the counterparty a fixed rate substantially equal to the fixed rate on the refunded bonds and receive a variable payment based on the one-month LIBOR rate, plus 30 basis points.

Once the refunded Series F 1999 Revenue Bonds escrow matures in 2019, the floating rate Series K 2010 Parity Bonds will be converted to tax-exempt bonds and the swap will convert to tax exempt rates as well. Should the option to enter the swap not be exercised by the counterparty, the University would not be required to repay the swaption purchase price.

Fair Value – At June 30, 2006, the swaption has a negative fair value of \$1,163,336. Such value was provided to the University by the counterparty, and was calculated is an approximation of market value derived from proprietary models and from certain other financial information believed to be reliable by the counterparty. The negative fair value of the swaption indicates that the fixed rate the University would pay under the potential transaction exceeded the one-month London InterBank Offering Rate (LIBOR) at June 30, 2006.

Market-access risk – If the option is exercised and variable-rate Series K 2010 Parity Bonds are not issued by the University, the Series F 1999 Revenue Bonds would not be refunded, and the University would make net swap payments as required by the terms of the swap.

Capital Leases

The University has future minimum lease commitments for capital lease obligations consisting of the following at June 30, 2006:

Fiscal Year	Total
2007	\$ 284,204
2008	177,151
2009	153,446
2010	105,270
2011	25,998
Minimum lease payments	\$ 746,069
Less: Amount representing interest	110,033
Present value of net minimum lease payments	<u>\$ 636,036</u>

NOTE 9 – REVENUE BONDS

Revenue bonds were issued pursuant to an Indenture of Trust between the Board of Regents of Higher Education for the State of Montana (on behalf of The University of Montana) and U. S. Bank Trust National Association MT. The bonds are secured by a first lien on the combined pledged revenues of the four campuses of The University of Montana. The pledged revenues earned at each campus are cross-pledged among all campuses of The University of Montana. Bonds payable recorded by each campus reflect the liability associated with the bond proceeds deposited into the accounts of that campus and do not necessarily mean that the debt service payments on that liability will be made by that campus.

The total aggregate principal amount originally issued pursuant to the Indenture of Trust and the various supplements to the Indenture for all campuses of The University of Montana at June 30, 2006 and 2005, was 169,426,780 and \$148,981,780, respectively. The combined principal amount outstanding at June 30, 2006 and 2005 was \$152,669,997 and \$139,595,000, respectively.

Series C 1995

On December 14, 1995, The University of Montana issued \$34,406,784 of Series C 1995 Revenue Bonds, with interest ranging from 3.80 percent to 5.75 percent. In fiscal year 2000, the Series F 1999 Revenue Bonds issuance advance refunded a portion of Series C 1995 revenue bonds.

Series E 1998

On June 26, 1998, The University of Montana issued \$10,670,000 of Series E 1998 Revenue Bonds, with interest ranging from 3.90 percent to 5.00 percent. The proceeds from the issue provided funds for the acquisition, construction, repair, replacement, renovation and improvement of certain facilities and properties.

Series F 1999

On November 12, 1999, The University of Montana issued \$69,240,000 of Series F 1999 Revenue Bonds, with interest rates ranging from 3.80 percent to 6.00 percent. The proceeds from the issue were used for the purpose of

Notes to the Consolidated Financial Statements (continued)

restructuring Series B, C and D Facilities Improvement Revenue Bonds, and for the acquisition, construction, remodeling, improvement and equipping certain facilities and properties at The University of Montana.

The University of Montana recorded \$58,205,000 of the Series F 1999 Revenue Bonds to advance refund \$58,609,189 of outstanding Series B, C and D Facilities Improvements Revenue Bonds with average interest rates ranging from 4.30 percent to 6.65 percent. The bonds are considered legally defeased and as a result, the liability for those bonds is no longer recorded in the consolidated financial statements.

Included in the Series F issuance was \$10,650,000 for construction of a new recreation facility at University's Missoula campus. In September, 2005, the Series J 2005 Revenue Bond issuance advanced refunded the outstanding principal amount of this portion of the Series F 1999 issuance (see Series J 2005 below).

Series G 2002

On October 18, 2002, The University of Montana issued \$18,900,000 of Series G Facilities Improvement Revenue Bonds, with interest ranging from 3.00 percent to 4.65 percent. The proceeds from the issue provided funds for the acquisition, construction, furnishing and equipping of certain student housing facilities on the Missoula campus.

Series H 2003

In April 2003, The University of Montana issued \$1,015,000 of Series H Facilities Improvement Revenue Bonds, with interest at 2.70 percent. The proceeds from the issue provided funds for the Washington Grizzly Stadium expansion on the Missoula campus.

Series I 2004

In April 2004, The University of Montana issued \$40,490,000 of Series I Refunding and Facilities Improvement Revenue Bonds, with interest ranging from 3.00 percent to 4.75 percent. The proceeds from the issue paid and discharged \$30,540,000 of Series A 1993, Revenue Bonds. The issuance also provided \$7,000,000 towards future expansion of the Skaggs Building and \$2,950,000 for deferred maintenance on the Missoula campus.

Series J 2005

On September 15, 2005, The University of Montana issued \$31,095,000 of Series J 2005 Facilities Improvement and Refunding Revenue Bonds, with interest ranging from 3.0 percent to 4.5 percent. The proceeds from the issue, together with certain resources of the University, will provide funds to pay and discharge a portion of the Series F Revenue Bonds, and finance or refinance, the costs of acquisition, construction, furnishing, equipping, renovation or improvement of certain University facilities.

The University of Montana recorded \$11,120,000 of the Series J 2005 Revenue Bonds to advance refund \$10,010,000 of outstanding Series F Facilities Improvement Revenue Bonds to reduce annual debt service payments. The interest rates on the advanced refunded revenue bonds ranged from \$4.80 percent to 6.00 percent. The bonds are considered legally defeased and as a result, the liability for those bonds is no longer recorded in the consolidated financial statements. The debt service cash flows for Series J 2005 Revenue Bonds (Refunding portion) are less than the debt service cash flows for the advanced refunded bonds by \$862,000. The economic gain for The University of Montana from the advanced refunding was \$600,786 (difference between the present values of the debt service payments on the old and new debt).

Defeased Bonds

The University has defeased certain bond issues by placing proceeds of new bonds in an irrevocable trust. The proceeds, together with interest earned thereon, will be sufficient for future debt service payments on the refunded issues. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's consolidated financial statements. As of June 30, 2006 and 2005, \$54,277,074 and \$47,236,073, respectively, of bonds outstanding were considered defeased.

Revenue Bonds Payable

As of June 30, 2006 annual principal payments are as follows:

Series C 1995 (Partial)

Fiscal Year	Interest Rate	Principal
2007	5.00 - 5.375%	\$ 425,000
2008	5.00 - 5.10%	450,000
2009	5.10 - 5.20%	475,000
2010	5.20 - 5.25%	495,000
2011	5.25%	525,000
		<u>\$ 2,370,000</u>

Series E 1998

Fiscal Year	Interest Rate	Principal
2007	4.40 - 4.45%	\$ 360,000
2008	4.45 - 4.50%	375,000
2009	4.50 - 4.60%	405,000
2010	4.60 - 4.70%	310,000
2011	4.70 - 4.80%	460,000
2012-2016	4.80 - 5.00%	2,340,000
2017-2021	5.00%	2,960,000
		<u>7,210,000</u>
Less unamortized discount:		23,891
		<u>\$ 7,186,109</u>

Series F 1999

Fiscal Year	Interest Rate	Principal
2007	4.90 - 5.00%	\$ 245,000
2008	5.00 - 5.10%	245,000
2009	5.10 - 5.20%	285,000
2010	5.20 - 5.35%	460,000
2011	5.25 - 5.35%	345,000
2012-2016	5.25 - 5.75%	6,994,997
2017-2021	5.75 - 6.00%	26,875,000
2022-2026	5.75 - 5.80%	22,320,000
		<u>57,769,997</u>
Less unamortized discount:		878,754
		<u>\$ 56,891,243</u>

Series G 2002

Fiscal Year	Interest Rate	Principal
2007	3.00%	\$ 455,000
2008	3.00%	465,000
2009	3.00%	480,000
2010	3.15 - 3.30%	420,000
2011	3.30 - 3.40%	430,000
2012-2016	3.40 - 4.10%	2,390,000
2017-2021	4.10 - 4.60%	2,905,000
2022-2026	4.60 - 4.65%	3,625,000
2027-2031	4.65%	4,560,000
2032-2033	4.65%	2,140,000
		<u>17,870,000</u>
Less unamortized discount:		43,368
		<u>\$ 17,826,632</u>

Notes to the Consolidated Financial Statements (continued)

Series H 2003

Fiscal Year	Interest Rate	Principal
2007	2.70%	\$ 200,000
2008	2.70%	215,000
		<u>\$ 415,000</u>

Series I 2004

Fiscal Year	Interest Rate	Principal
2007	3.00%	\$ 2,540,000
2008	3.00%	2,620,000
2009	3.00 - 3.50%	2,660,000
2010	3.50%	2,710,000
2011	3.50%	2,800,000
2012-2016	3.50 - 4.75%	14,255,000
2017-2021	4.375%	435,000
2022-2026	4.375 - 4.50%	7,095,000
2027-2030	4.50%	1,780,000
		<u>36,895,000</u>
Add net unamortized premium:		946,824
		<u>\$ 37,841,824</u>

Series J 2005

Fiscal Year	Interest Rate	Principal
2007	3.25 - 3.50%	\$ 880,000
2008	3.50 - 4.00%	1,240,000
2009	4.00 - 4.50%	1,285,000
2010	4.50%	1,330,000
2011	4.25 - 4.50%	990,000
2012-2016	4.00 - 4.50%	5,575,000
2017-2021	4.00 - 4.25%	6,540,000
2022-2026	4.00 - 4.25%	7,950,000
2027-2030	4.25%	4,350,000
		<u>30,140,000</u>
Add net unamortized premium:		50,399
		<u>\$ 30,190,399</u>

Revenue Bond Payable Summary:

Total revenue bonds outstanding	\$152,669,997
Add: Net unamortized premium	51,210
Less: Unamortized loss on advance refunding	<u>2,713,432</u>
Revenue bonds payable, net	<u>\$150,007,775</u>

The scheduled maturities of the revenue bonds payable are as follows:

Fiscal Year	Principal	Interest	Total Payment
2007	\$ 5,105,000	\$ 7,005,945	\$ 12,110,945
2008	5,610,000	7,052,585	12,662,585
2009	5,590,000	6,858,005	12,448,005
2010	5,725,000	6,644,550	12,369,550
2011	5,550,000	6,411,001	11,961,001
2012-2016	31,554,997	28,224,763	59,779,760
2017-2021	39,715,000	19,900,818	59,615,818
2022-2026	40,990,000	8,262,730	49,252,730
2027-2031	10,690,000	1,829,044	12,519,044
2032-2033	2,140,000	150,428	2,290,428
	<u>\$ 152,669,997</u>	<u>\$ 92,339,869</u>	<u>\$ 245,009,866</u>

NOTE 10 – NOTES PAYABLE

Notes payable at June 30, 2006 consisted of the following:

Description	Interest Rate	Maturity Date	Principal Outstanding	Current Maturities
First Interstate Bank	7.00%	15-Oct-15	\$ 197,947	\$ 16,065
Ames Construction, Inc.	3.085%	01-Nov-08	962,839	331,257
Wells Fargo Bank	4.48%	1-May-15	430,178	39,774
			<u>\$ 1,590,964</u>	<u>\$ 387,096</u>

The scheduled maturities of the notes payable are as follows:

Fiscal Year	Principal	Interest	Total Payment
2007	\$ 387,096	\$ 32,180	\$ 419,276
2008	423,343	29,251	452,594
2009	328,936	26,091	355,027
2010	65,233	22,786	88,019
2011	68,722	19,297	88,019
2012-2016	317,634	38,236	355,870
	<u>\$ 1,590,964</u>	<u>\$ 167,841</u>	<u>\$ 1,758,805</u>

NOTE 11 – COMPENSATED LEAVE

Employee compensated absences are accrued at year-end for consolidated financial statement purposes. The liability and expense incurred are recorded at year-end as accrued compensated absences in the Statements of Net Assets, and as a component of compensation and benefit expense in the Statements of Revenues, Expenses, and Changes in Net Assets.

NOTE 12 – ADVANCES FROM PRIMARY GOVERNMENT

Advances from the primary government are received through the InterCap Program offered through the Montana Board of Investments. The program lends money to state agencies, including the Montana University System, for the purpose of financing or refinancing the acquisition and installation of equipment or personal and real property and infrastructure improvements.

The Montana Science and Technology Alliance (MSTA) loan originates from a loan that was originally issued in 1994, and has a remaining term of 56 years. The interest rates are variable and are adjusted annually.

Advances from Primary Government at June 30, 2006, are as follows:

Description	Interest Rate	Maturity Date	Principal Outstanding
InterCap – Network Engineering	Variable	15-Feb-07	\$ 30,532
InterCap – Weight Room Expansion	Variable	15-Feb-09	82,759
InterCap – Real Estate	Variable	15-Feb-12	52,765
InterCap – IT Wiring and Fiber	Variable	15-Aug-10	186,112
InterCap – Lubrecht Forest	Variable	15-Aug-08	57,654
InterCap – Intercollegiate Athletics	Variable	15-Feb-10	217,428
InterCap – Public Safety	Variable	15-Aug-16	288,723
InterCap – Dining Services	Variable	15-Aug-08	12,751
InterCap – Forestry	Variable	15-Aug-14	866,019
InterCap – Campus Mail	Variable	15-Aug-08	8,365
InterCap – Facility Services	Variable	15-Feb-10	70,072

Notes to the Consolidated Financial Statements (continued)

Intercap – Public Safety	Variable	15-Feb-13	359,875
Intercap – Microwave Network	Variable	15-Aug-11	56,006
MSTA loan – Research Offices	Variable	30-June-61	<u>3,552,234</u>
			5,841,295
Less Current Maturities			<u>374,816</u>
			<u>\$ 5,466,479</u>

The scheduled maturities of the Intercap loans and MST A loan are as follows:

Fiscal Year	Principal	Interest	Total Payment
2007	\$ 374,816	\$ 188,547	\$ 563,363
2008	390,118	176,064	566,182
2009	388,144	158,270	546,414
2010	354,343	141,013	495,356
2011	264,967	125,709	390,676
2012-2016	849,218	482,955	1,332,173
2017-2021	228,376	389,976	618,352
2022-2026	238,073	361,927	600,000
2027-2031	269,323	330,677	600,000
2032-2036	304,676	295,324	600,000
2037-2041	344,669	255,331	600,000
2042-2046	389,912	210,088	600,000
2047-2051	441,094	158,906	600,000
2052-2056	498,994	101,006	600,000
2057-2061	504,572	35,552	540,124
	<u>\$ 5,841,295</u>	<u>\$ 3,411,345</u>	<u>\$ 9,252,640</u>

NOTE 13 – RETIREMENT PLANS

Full-time employees of the University are members of the Public Employees' Retirement System (PERS), Game Wardens' & Peace Officers' Retirement System (GWPORS), Teachers' Retirement System (TRS) or the Optional Retirement Program (ORP) as described below. Only faculty and administrators with contracts under the authority of the Board of Regents are enrolled under TRS or ORP. Beginning July 1, 1993, state legislation required all new faculty and administrators with contracts under the authority of the Board of Regents to enroll in ORP.

PERS, GWPORS and TRS

PERS, GWPORS and TRS are statewide, cost-sharing, multiple-employer defined benefit retirement plans. The plans are established under state law and are administered by the State of Montana. The plans provide retirement, disability, and death benefits to plan members and beneficiaries. PERS, a mandatory system established by the state in 1945, provides retirement services to substantially all public employees. GWPORS, established in 1963, provides retirement benefits for all persons employed as a game warden, warden supervisory personnel, and state police officers not eligible to join the Sheriffs' Retirement System, Highway Patrol Officers' Retirement System, and Municipal Police Officers' Retirement System. TRS, established in 1937, provides retirement services to all persons employed as teachers or professional staff of any public elementary or secondary school, or unit of the University System.

Contribution rates for the plans are required and determined by state law. The contribution rates for 2006 and 2005 expressed as a percentage of covered payrolls were as follows:

	2006			2005		
	Covered Payroll	Employee	Employer	Covered Payroll	Employee	Employer
PERS	\$ 36,729,189	6.90%	6.90%	\$ 34,348,500	6.90%	6.90%
GWPORS	\$ 488,344	10.43%	9.00%	\$ 425,938	10.50%	9.48%
TRS	\$ 20,748,781	8.59%	7.47%	\$ 22,555,691	8.32%	7.47%

The amounts contributed to the plan during years ending June 30, 2006, 2005, and 2004, were equal to the required contribution each year. The amounts contributed were as follows:

	Year ending June 30,		
	2006	2005	2004
<u>PERS</u>			
Employer	\$ 2,534,423	\$ 2,370,217	\$ 2,307,287
Employee	\$ 2,532,872	\$ 2,370,043	\$ 2,306,542
<u>GWPORS</u>			
Employer	\$ 43,951	\$ 40,373	\$ 40,909
Employee	\$ 50,944	\$ 44,779	\$ 48,000
<u>TRS</u>			
Employer	\$ 1,548,934	\$ 1,685,188	\$ 1,767,774
Employee	\$ 1,782,528	\$ 2,201,136	\$ 2,100,459

The plans issue publicly available annual reports that include financial statements and required supplemental information. The reports may be obtained from the following:

Public Employees' Retirement Administration
P.O. Box 200131
100 North Park, Suite 220
Helena, Montana 59620-0131
Phone: (406) 444-3154

Teachers' Retirement Division
P.O. Box 200139
1500 Sixth Avenue
Helena, MT 59620-0139
Phone: (406) 444-3134

ORP

ORP was established in 1988, and is underwritten by the Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF). The ORP is a defined-contribution plan. Until July 1, 2003, only faculty and staff with contracts under the authority of the Board of Regents were eligible to participate. The plan was changed, effective July 1, 2003, to allow all staff to participate in the ORP. Contribution rates for the plan are required and determined by state law. The University's contributions were equal to the required contribution. The benefits at retirement depend upon the amount of contributions, amounts of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. The University records employee/employer contributions and remits monies to TIAA-CREF. Individuals vest immediately in the employer portion of retirement contributions.

Contributions to ORP (TIAA-CREF) were as follows:

	Year ending June 30,	
	2006	2005
<u>FACULTY</u>		
Covered Payroll	\$55,447,659	\$50,515,235
Employer Contributions	\$2,747,986	\$2,503,535
Percent of Covered Payroll	4.956%	4.956%
Employee Contributions	\$3,900,627	\$3,558,187
Percent of Covered Payroll	7.043%	7.043%

Notes to the Consolidated Financial Statements (continued)

STAFF

Covered Payroll	\$7,272,670	\$6,730,564
Employer Contributions	\$326,543	\$302,202
Percent of Covered Payroll	4.49%	4.49%
Employee Contributions	\$501,815	\$463,606
Percent of Covered Payroll	6.90%	6.90%

For the years ended June 30, 2006 and 2005, \$2,207,843 and \$2,040,815, respectively, or 4.04 percent, was contributed to TRS from ORP faculty employer contributions to amortize past service unfunded liability in accordance with state law. In addition, \$175,271 and, \$161,404 respectively, or 2.41% was contributed to PERS from ORP staff employer contributions to amortize past service unfunded liability in accordance with state law.

Annual reports that include financial statements and required supplemental information on the plan are available from:

TIAA-CREF
730 Third Avenue
New York, New York 10017-3206
Phone: 1-800-842-2733

NOTE 14 – RISK MANAGEMENT

Due to the diverse risk exposure of the University and its constituent agencies, the insurance portfolio contains a comprehensive variety of coverage. Montana statutes, 2-9-101 through 305, MCA, and ARM 2-2-298, require participation of all state agencies in the self-insurance plan established by the Montana Department of Administration, Risk Management and Tort Defense Division (RMTDD). The self-insurance program includes coverage for commercial general liability, auto liability, professional liability, and errors and omissions exposures. The RMTDD provides coverage, above self-insured retentions, by purchasing other commercial coverage through the state's broker, Willis of Seattle, for excess liability, property, crime, fidelity, boiler and machinery, fine arts, aircraft-liability and hull coverage. The RMTDD also supplies other commercial insurance coverage for specific risk exposures on an as-needed basis such as the Volunteer Accident and Health, Dismemberment and Accidental Death coverage obtained for all units of the Montana University System. In addition to these basic policies, the University has established guidelines in risk assessment, risk avoidance, risk acceptance and risk transfer.

The Tort Claims Act of the State of Montana in section, 2-9-102, MCA, "provides that Governmental entities are liable for its torts and of those of its employees acting within the course and scope of their employment or duties whether arising out of a governmental or proprietary function, except as specifically provided by the Legislature". Accordingly section, 2-9-305, MCA, requires that the state "provide for the immunization, defense and indemnification of its public officers and employees civilly sued for their actions taken within the course and scope of their employment". The University also has commercial coverage for other risk exposures that are not covered by the State's self-insurance program.

Buildings and contents – are insured for replacement value. For each loss covered by the state's self-insurance program and commercial coverage, the University has a \$1,000 per occurrence retention.

General liability and tort claim coverage – include comprehensive general liability, auto liability, personal injury liability, officer's and director's liability, professional liability, aircraft liability, watercraft liability, leased vehicles and equipment liability, and are provided for by the University's participation in the state's self-insurance program.

Self-Funded Programs – The University's health care program is self-funded, and is provided through participation in the Montana University System (MUS) Inter-unit Benefits Program. The MUS program is funded on an actuarial basis and the University believes that sufficient reserves exist to pay run-off claims related to prior years, and that the premiums and University contributions are sufficient to pay current and future claims.

Effective July 1, 2003, (for fiscal year 2004), the University's workers' compensation program became self-funded and is provided through membership in the MUS Self Insured Workers' Compensation Program. In fiscal year 2003 the University's workers' compensation coverage was provided for through participation in the state's Compensation Insurance Fund. The MUS self-funded program is funded on an actuarial basis and is administered by a third party, currently Missoula County. The MUS program incorporates a self-insured retention of \$500,000 per claim and excess commercial coverage to statutory limits. Employer's liability is provided with a \$500,000 retention and an excess insurance limit of \$1,000,000. The University provides periodic disbursements to the administrator for claims paid and administrative expenses. Benefits provided are prescribed by state law and include biweekly payments for temporary loss of wages as well as qualifying permanent partial and permanent total disability. Medical and indemnity benefits are statutorily prescribed for qualifying job-related injuries or illnesses.

NOTE 15 – COMMITMENTS AND CONTINGENCIES

At June 30, 2006, the University had the following outstanding commitments under major capital and maintenance projects:

Project	Budget Authorization	Total Expenditures through June 2006	Funding Source
Skaggs Building Addition	\$ 14,000,000	\$ 8,744,803	2004 Series I Revenue Bonds, Donations, Grants
Chemistry Building Renovation	825,000	819,370	General Operating and Plant Funds, Donations
Journalism Building	12,500,000	5,575,345	InterCap Loan, Donations and Plant Funds
Law School Expansion	5,500,000	276,885	Donations
Research Facility	12,000,000	109,692	2005 Series J Revenue Bonds
Dormitory Sprinkler System	750,000	100,335	2005 Series J Revenue Bonds and Plant Funds
MGMB & Petroleum Building	14,400,000	97,340	Long Range Building Plan and Plant Funds
Biomass Energy System	1,425,758	416,252	Federal Grant and State Bond Proceeds
Auxiliary Steamline	1,795,000	26,423	2005 Series J Revenue Bonds
Upgrade Boiler Controls	275,000	250,496	General Operating and Plant Funds
Curry Health Center HVAC	589,378	30,392	Auxiliary, Plant, and Designated Funds
Renovate Mouse House	226,444	206,567	General Operating and Designated Funds
Clapp Bldg Relocation	255,500	166,891	General Operating
Chemistry NMR Room Renovation	111,505	94,197	Grant, Designated Funds
COT Futures Park	100,000	95,000	Research & Development
Science Complex Network Maintenance	125,000	106,123	Technology Fees
Donaldson Bldg Expansion	175,000	21,904	Plant Funds
	<u>\$ 65,053,585</u>	<u>\$ 17,138,015</u>	

Operating leases – The University has commitments under non-cancelable operating leases as follows:

Payable during the year ending June 30,	Total
2007	\$ 171,015
2008	57,323
2009	17,929
	<u>\$ 246,267</u>

The University is a defendant in several legal actions. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on the University's financial position.

In the normal course of operations, the University receives grants and other forms of reimbursement from various federal and state agencies. These funds are subject to review and audit by the cognizant agencies. The University does not expect any material adjustments or repayments to result from such audits.

Notes to the Consolidated Financial Statements (continued)

Although the University is exempt from federal income tax as an instrumentality of the State of Montana, certain income may be considered unrelated business income by the Internal Revenue Service (IRS). The Montana University System files appropriate tax returns with the IRS to report such income. Because the tax liability for the System as a whole is not material, no provision is recorded in the accompanying consolidated financial statements.

NOTE 16– RELATED PARTIES

The University of Montana is a component unit of the State of Montana. The University's consolidated financial statements and the combined financial statements of its component units include only the activities, funds and accounts of the University and the component units. Private nonprofit organizations with relations to the University include The University of Montana Alumni Association, the Montana Technology Enterprise Center (MonTEC), the Montana Tech Booster Club, the Montana Tech Alumni Association and the University of Montana – Western Booster Club.

The associations and booster clubs operate exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with the University. For the years ended June 30, 2006 and 2005, the following was transferred from or expended by booster clubs for scholarships and construction projects: from the Montana Tech Booster Club \$53,862 and \$65,539, respectively; and \$78,503 and \$52,345, respectively from the University of Montana – Western Booster Club. In exchange, the University provides the associations and booster clubs with office space, staff and some related office expenses.

MonTEC was established as a nonprofit 501 (c) 3 corporation in fiscal year 2001 as a result of an agreement between the University and the Missoula Area Economic Development Foundation (MAEDF). MonTEC provides low cost lease space and business consulting to local "start-up" companies. The corporation's board of directors is comprised equally of members appointed by MAEDF and the University.

NOTE 17 - ACCOUNTING FOR COMPONENT UNITS

The entities included as component units in the financial statements are nonprofit, tax exempt organizations operating exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with the University. Although the University does not control the timing or amount of receipts from these entities, the majority of the revenues or income that the entities hold and invest is restricted to the activities of the University by donors. The entities included as component units in the financial statements are The University of Montana Foundation, The Montana Tech Foundation, The University of Montana – Western Foundation and The Montana Grizzly Scholarship Association.

For the fiscal years ended June 30, 2006 and 2005, the following was transferred to the University for scholarships, academic or institutional support or capital expenses by the University foundations: \$12,626,150 and \$9,171,475, respectively with The University of Montana Foundation (406-243-2593), \$1,407,020 and \$1,384,656, respectively with the Montana Tech Foundation (406-496-4532); and \$233,928 and \$194,937, respectively with The University of Montana-Western Foundation (406-683-7305). In addition, \$1,010,755 and \$1,032,507 was transferred from the Montana Grizzly Scholarship Association (406-243-6485) for the fiscal years ended June 30, 2006 and 2005, respectively. For the fiscal years ended June 30, 2006 and 2005, the University foundations also expended \$3.5 million and \$4.1 million, respectively, directly to third parties in support of the University. In exchange, the University provides the foundations with office space and an annually contracted fee, and the association with office space, staff and some related office expenses. For the fiscal years ended June 30, 2006 and 2005, the University provided \$332,820 and \$392,600, respectively, to its Foundations, which included payments for contracted services and capital campaign support.

Condensed financial information for each of the University's component units is presented below. The information for The University of Montana – Western Foundation is as of December 31, for the years presented. The financial information for all the other component units is as of June 30, for the years presented.

STATEMENT OF FINANCIAL POSITION

June 30, 2006 and December 31, 2005

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association*	Total
ASSETS					
Cash and investments	\$ 139,056,228	\$ 22,572,158	\$ 3,836,474	\$ 1,438,834	\$166,903,694
Other receivables, net of allowances	17,000,021	814,894	-	88,394	17,903,309
Fixed assets, net of depreciation	4,744,545	197,595	-	7,194	4,949,334
Other assets	466,311	5,393	-	46,528	518,232
	<u>\$ 161,267,105</u>	<u>\$ 23,590,040</u>	<u>\$ 3,836,474</u>	<u>\$ 1,580,950</u>	<u>\$190,274,569</u>
LIABILITIES AND NET ASSETS					
Current liabilities associated with operations	\$ 230,235	\$ 18,125	\$ 5,827	\$ 187,848	\$ 442,035
Note payable – other	429,614	129,372	40,000	-	598,986
Long-term liabilities - other	-	75,712	-	-	75,712
Liabilities to external beneficiaries	2,786,406	-	-	-	2,786,406
Custodial funds	19,582,375	-	-	-	19,582,375
	<u>23,028,630</u>	<u>223,209</u>	<u>45,827</u>	<u>187,848</u>	<u>23,485,514</u>
Net assets – unrestricted	6,640,375	3,057,125	246,992	506,314	10,450,806
Net assets – restricted	131,598,100	20,309,706	3,543,655	886,788	156,338,249
	<u>138,238,475</u>	<u>23,366,831</u>	<u>3,790,647</u>	<u>1,393,102</u>	<u>166,789,055</u>
	<u>\$ 161,267,105</u>	<u>\$ 23,590,040</u>	<u>\$ 3,836,474</u>	<u>\$ 1,580,950</u>	<u>\$190,274,569</u>

* For the year ended June 30, 2006

** For the year ended December 31, 2005

STATEMENT OF FINANCIAL POSITION

June 30, 2005 and December 31, 2004

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association*	Total
ASSETS					
Cash and investments	\$ 127,148,400	\$ 20,637,712	\$ 3,617,368	\$ 1,036,163	\$152,439,643
Amounts due from institution or other component units	-	-	-	41,000	41,000
Other receivables, net of allowances	15,235,565	884,387	2,970	79,673	16,202,595
Fixed assets, net of depreciation	4,796,943	162,321	-	7,248	4,966,512
Other assets	401,203	4,284	-	116,621	522,108
	<u>\$ 147,582,111</u>	<u>\$ 21,688,704</u>	<u>\$ 3,620,338</u>	<u>\$ 1,280,705</u>	<u>\$174,171,858</u>
LIABILITIES AND NET ASSETS					
Current liabilities associated with operations	\$ 462,250	\$ 30,110	\$ 584	\$ 261,274	\$ 754,218
Note payable – other	100,000	145,214	40,000	-	285,214
Note payable – long-term	358,053	-	-	-	358,053
Long-term liabilities - other	140,555	80,934	-	-	221,489
Liabilities to external beneficiaries	2,401,751	-	-	-	2,401,751
Custodial funds	16,721,398	-	-	-	16,721,398
	<u>20,184,007</u>	<u>256,258</u>	<u>40,584</u>	<u>261,274</u>	<u>20,742,123</u>
Net assets – unrestricted	6,092,985	2,936,944	241,644	287,708	9,559,281
Net assets – restricted	121,305,119	18,495,502	3,338,110	731,723	143,870,454
	<u>127,398,104</u>	<u>21,432,446</u>	<u>3,579,754</u>	<u>1,019,431</u>	<u>153,429,735</u>
	<u>\$ 147,582,111</u>	<u>\$ 21,688,704</u>	<u>\$ 3,620,338</u>	<u>\$ 1,280,705</u>	<u>\$174,171,858</u>

* For the year ended June 30, 2005

** For the year ended December 31, 2004

Notes to the Consolidated Financial Statements (continued)

STATEMENT OF ACTIVITY For the year ended June 30, 2006 and December 31, 2005

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association *	Total
REVENUES					
Contributions	\$ 18,837,004	\$ 2,276,408	\$ 453,375	\$ 1,413,584	\$ 22,980,371
Investment income and unrealized gain(loss) of investments	10,298,376	1,488,727	138,263	11,956	11,937,322
Contract for services	278,000	260,325	155,773	450,938	1,145,036
Other income	658,991	10,695	41,575	-	711,261
	\$ 30,072,371	\$ 4,036,155	\$ 788,986	\$ 1,876,478	\$ 36,773,990
EXPENSES					
Program services	\$ 15,435,500	\$ 1,407,020	\$ 392,177	\$ 1,010,755	\$ 18,245,452
Supporting services	3,105,934	694,750	185,916	492,052	4,478,652
	\$ 18,541,434	\$ 2,101,770	\$ 578,093	\$ 1,502,807	\$ 22,724,104
Change in net assets before non- operating items	\$ 11,530,937	\$ 1,934,385	\$ 210,893	\$ 373,671	\$ 14,049,886
NONOPERATING EXPENSES					
Payments to beneficiaries and change in liabilities due to external beneficiaries	(690,566)	-	-	-	(690,566)
Change in net assets	10,840,371	1,934,385	210,893	373,671	13,359,320
Net assets, beginning of fiscal year	\$127,398,104	\$ 21,432,446	\$ 3,579,754	\$ 1,019,431	\$153,429,735
Net assets, end of fiscal year	\$138,238,475	\$ 23,366,831	\$ 3,790,647	\$ 1,393,102	\$166,789,055

* For the year ended June 30, 2006

** For the year ended December 31, 2005

STATEMENT OF ACTIVITY For the year ended June 30, 2005 and December 31, 2004

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association *	Total
REVENUES					
Contributions	\$ 18,318,808	\$ 2,573,871	\$ 362,619	\$ 1,404,714	\$ 22,660,012
Investment income and unrealized gain(loss) of investments	6,073,256	1,435,802	247,519	17,509	7,774,086
Contract for services	278,000	104,600	-	-	382,600
Other income	655,680	194,592	215,322	580,940	1,646,534
	\$ 25,325,744	\$ 4,308,865	\$ 825,460	\$ 2,003,163	\$ 32,463,232
EXPENSES					
Program services	\$ 9,171,475	\$ 1,384,656	\$ 409,654	\$ 1,366,676	\$ 12,332,461
Supporting services	2,813,054	690,832	180,995	233,054	3,917,935
	\$ 11,984,529	\$ 2,075,488	\$ 590,649	\$ 1,599,730	\$ 16,250,396
Change in net assets before non- operating items	\$ 13,341,215	\$ 2,233,377	\$ 234,811	\$ 403,433	\$ 16,212,836
NONOPERATING REVENUES (EXPENSES)					
Payments to beneficiaries and change in liabilities due to external beneficiaries	(321,927)	-	-	-	(321,927)
Adjustments to net assets	(4,948,229)	-	-	(12,926)	(4,961,155)
Change in net assets	8,071,059	2,233,377	234,811	390,507	10,929,754
Net assets, beginning of fiscal year	\$119,327,045	\$ 19,199,069	\$ 3,344,943	\$ 628,924	\$142,499,981
Net assets, end of fiscal year	\$127,398,104	\$ 21,432,446	\$ 3,579,754	\$ 1,019,431	\$153,429,735

* For the year ended June 30, 2004

** For the year ended December 31, 2003

The following table shows the total investments held by the component units. The investments for The University of Montana – Western Foundation are as of December 31, 2005 and 2004. The financial information for all the other component units is as of June 30, 2006 and 2005.

	Fair Market Value	
	2006	2005
Investments held by component units:		
Stocks and bonds	\$ 145,054,040	\$ 141,948,586
Money market and certificates of deposit	10,895,232	212,280
Real property	542,526	652,526
Other	336,145	5,236,139
	<u>\$ 156,827,943</u>	<u>\$ 148,049,531</u>

Notes to the Consolidated Financial Statements (continued)

NOTE 18 – NATURAL CLASSIFICATION WITH FUNCTIONAL CLASSIFICATIONS

The University's operating expenses by natural and functional classifications for the year ended June 30, 2006, were as follows:

Functional Classification:	Natural Classification						Total
	Compensation & benefits	Supplies & other services	Utilities	Communication	Scholarships	Depreciation	
Instruction	\$ 76,556,674	\$ 7,975,449	\$ 9,987	\$ 429,664	\$ -	\$ -	\$ 84,971,774
Research	29,848,674	16,720,458	116,864	237,711	-	-	46,923,707
Public service	7,578,315	3,243,740	-	86,339	-	-	10,908,394
Academic support	14,386,404	5,848,594	-	255,738	-	-	20,490,736
Student services	12,201,060	7,659,928	7,587	381,472	-	-	20,250,047
Institutional support	15,641,486	6,437,828	73	664,322	-	-	22,743,709
Operation and maintenance of plant	9,804,566	4,387,456	5,307,416	382,155	-	-	19,881,593
Scholarships and fellowships	-	-	-	-	15,282,299	-	15,282,299
Auxiliary enterprises	19,864,853	10,023,681	3,252,037	357,206	-	-	33,497,777
Depreciation	-	-	-	-	-	16,710,382	16,710,382
	\$ 185,882,032	\$ 62,297,134	\$ 8,693,964	\$ 2,794,607	\$ 15,282,299	\$ 16,710,382	\$ 291,660,418

The University's operating expenses by natural and functional classifications for the year ended June 30, 2005, were as follows:

Functional Classification:	Natural Classification						Total
	Compensation & benefits	Supplies & other services	Utilities	Communication	Scholarships	Depreciation	
Instruction	\$ 72,227,632	\$ 7,585,715	\$ 7,503	\$ 442,620	\$ -	\$ -	\$ 80,263,470
Research	30,415,527	18,509,948	147,605	261,956	-	-	49,335,036
Public service	5,690,505	3,516,585	-	111,717	-	-	9,318,807
Academic support	13,278,589	5,558,124	-	290,563	-	-	19,127,276
Student services	11,305,080	7,521,012	2,072	384,897	-	-	19,213,061
Institutional support	14,317,003	5,757,501	205	726,479	-	-	20,801,188
Operation and maintenance of plant	9,404,701	6,281,563	4,787,379	133,804	-	-	20,607,447
Scholarships and fellowships	-	-	-	-	15,696,669	-	15,696,669
Auxiliary enterprises	19,210,229	7,369,582	2,968,474	365,589	-	-	29,913,874
Depreciation	-	-	-	-	-	16,068,885	16,068,885
	\$ 175,849,266	\$ 62,100,030	\$ 7,913,238	\$ 2,717,625	\$ 15,696,669	\$ 16,068,885	\$ 280,345,713

The University of Montana

Supplemental Information - All Campuses

(Unaudited)

<u>DESCRIPTION</u>	<u>Fall 2005</u>	<u>Fall 2004</u>	<u>Fall 2003</u>	<u>Fall 2002</u>	<u>Fall 2001</u>
Enrollment (Headcount) ¹	17,919	17,796	17,595	17,175	16,703
	<u>FY2006</u>	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>	<u>FY2002</u>
Enrollment (FTE) ²					
Colleges of Technology	2,055	1,881	1,905	1,858	1,833
Undergraduate	11,985	12,026	12,149	12,052	11,871
Graduate	1,747	1,765	1,772	1,630	1,582
Enrollment (FTE) ²					
In-State students	12,215	12,225	12,402	12,070	11,683
Out-of-State students	2,710	2,675	2,699	2,901	2,981
Western Undergraduate Exchange	862	772	725	569	622
	<u>FY2006</u>	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>	<u>FY2002</u>
Employees (FTE) - All Funds ³					
Contract Faculty	993	985	961	937	901
Contract Admin & Professional	386	401	390	366	347
Classified	1,283	1,275	1,265	1,266	1,249
GTA/GRA	173	178	167	170	157
Part Time and Other	403	385	360	378	397
	<u>School Year Ended</u>	<u>6/30/2005</u>	<u>6/30/2004</u>	<u>6/30/2003</u>	<u>6/30/2002</u>
Degrees Granted ⁴	<u>6/30/2006</u>				
Certificate	102	76	47	79	84
Associate	478	467	510	492	479
Undergraduate	2,034	2,192	2,242	2,136	2,182
Graduate	711	698	673	620	666

¹ Source: MUS Data Warehouse

² Source: Internal management reports 2000-2001, CHE Operating Reports 2002-2007

³ Source: CHE Operating Reports 2000-2007

⁴ Source: IPEDS Completion Reports, Fall 2000-2005, internal management reports



The University of
Montana

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11 December 2006

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
Room 135 State Capitol
P. O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

We thank the Legislative Audit staff for the cooperation and effort devoted to The University of Montana Financial Audit for the 2006 Fiscal Year. We found the audit team professional and cooperative at all times. The financial audit has become an efficient means to provide the public with an accounting of The University of Montana, and we very much appreciate it.

Thank you and the staff very much for the cooperative efforts. Please convey to the staff members our gratitude for the assistance. We will continue to make improvements and strive to provide accountability in all aspects of our operations.

Sincerely,

George M. Dennison
President

c: D. Dwyer, Vice President for Research and Economic Development
S. Stearns, Commissioner of Higher Education

GMD/cc
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